

HORTON D R INC /DE/  
Form 10-Q  
July 27, 2018  
Table of Contents

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

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FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended June 30, 2018  
Commission file number 1-14122

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D.R. Horton, Inc.  
(Exact name of registrant as specified in its charter)  
Delaware 75-2386963  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1341 Horton Circle  
Arlington, Texas 76011  
(Address of principal executive offices) (Zip  
Code)

(817) 390-8200  
(Registrant's telephone number, including area  
code)

Not Applicable  
(Former name, former address and former fiscal  
year, if changed since last report)

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Emerging growth company   
(Do not check if a smaller reporting company)

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, \$.01 par value – 377,068,508 shares as of July 23, 2018

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D.R. HORTON, INC. AND SUBSIDIARIES  
FORM 10-Q  
INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets at June 30, 2018 and September 30, 2017</u>	<u>3</u>
<u>Consolidated Statements of Operations for the three and nine months ended June 30, 2018 and 2017</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the nine months ended June 30, 2018 and 2017</u>	<u>5</u>
<u>Notes to Consolidated Financial Statements</u>	<u>6</u>
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>43</u>
<u>ITEM 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>70</u>
<u>ITEM 4. Controls and Procedures</u>	<u>71</u>
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. Legal Proceedings</u>	<u>72</u>
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>72</u>
<u>ITEM 6. Exhibits</u>	<u>73</u>
<u>SIGNATURE</u>	<u>74</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## D.R. HORTON, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

	June 30, 2018	September 30, 2017
	(In millions)	
	(Unaudited)	
<b>ASSETS</b>		
Cash and cash equivalents	\$1,178.2	\$ 1,007.8
Restricted cash	58.7	16.5
Inventories:		
Construction in progress and finished homes	5,194.8	4,606.0
Residential land and lots — developed and under development	4,948.2	4,519.7
Land held for development	117.0	101.0
Land held for sale	43.3	10.4
	10,303.3	9,237.1
Investment in unconsolidated entities	32.2	—
Mortgage loans held for sale	679.9	587.3
Deferred income taxes, net of valuation allowance of \$29.3 million and \$11.2 million at June 30, 2018 and September 30, 2017, respectively	204.6	365.0
Property and equipment, net	385.2	325.0
Other assets	642.1	565.9
Goodwill	109.2	80.0
Total assets	\$13,593.4	\$ 12,184.6
<b>LIABILITIES</b>		
Accounts payable	\$655.3	\$ 580.4
Accrued expenses and other liabilities	1,074.6	985.0
Notes payable	3,093.6	2,871.6
Total liabilities	4,823.5	4,437.0
Commitments and contingencies (Note K)		
<b>EQUITY</b>		
Preferred stock, \$.10 par value, 30,000,000 shares authorized, no shares issued	—	—
Common stock, \$.01 par value, 1,000,000,000 shares authorized, 387,651,773 shares issued and 376,993,165 shares outstanding at June 30, 2018 and 384,036,150 shares issued and 374,986,079 shares outstanding at September 30, 2017	3.9	3.8
Additional paid-in capital	3,064.4	2,992.2
Retained earnings	5,798.8	4,946.0
Treasury stock, 10,658,608 shares and 9,050,071 shares at June 30, 2018 and September 30, 2017, respectively, at cost	(269.8	) (194.9
Stockholders' equity	8,597.3	7,747.1
Noncontrolling interests	172.6	0.5
Total equity	8,769.9	7,747.6
Total liabilities and equity	\$13,593.4	\$ 12,184.6

See accompanying notes to consolidated financial statements.

3

---

Table of ContentsD.R. HORTON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2018		Nine Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In millions, except per share data)			
	(Unaudited)			
Revenues	\$4,435.3	\$3,776.4	\$11,562.9	9,931.9
Cost of sales	3,397.2	2,961.1	8,939.0	7,778.9
Selling, general and administrative expense	434.9	374.5	1,219.9	1,055.5
Equity in earnings of unconsolidated entities	(0.4 )	—	(3.1 )	—
Gain on sale of assets	—	—	(14.5 )	—
Other (income) expense	(12.6 )	(3.7 )	(30.7 )	(19.0 )
Income before income taxes	616.2	444.5	1,452.3	1,116.5
Income tax expense	162.5	155.5	458.9	391.4
Net income	453.7	289.0	993.4	725.1
Net loss attributable to noncontrolling interests	(0.1 )	—	(0.7 )	—
Net income attributable to D.R. Horton, Inc.	\$453.8	\$289.0	\$994.1	\$725.1
Basic net income per common share attributable to D.R. Horton, Inc.	\$1.20	\$0.77	\$2.64	\$1.94
Weighted average number of common shares	377.4	374.8	376.6	374.1
Diluted net income per common share attributable to D.R. Horton, Inc.	\$1.18	\$0.76	\$2.59	\$1.92
Adjusted weighted average number of common shares	383.4	379.4	383.6	378.5
Cash dividends declared per common share	\$0.125	\$0.10	\$0.375	\$0.30

See accompanying notes to consolidated financial statements.

4

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Table of ContentsD.R. HORTON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30, 2018      2017 (In millions) (Unaudited)	
<b>OPERATING ACTIVITIES</b>		
Net income	\$993.4	\$725.1
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	46.6	40.4
Amortization of discounts and fees	6.3	3.9
Stock based compensation expense	46.3	40.4
Equity in earnings of unconsolidated entities	(3.1)	)
Distributions of earnings of unconsolidated entities	0.2	—
Excess income tax benefit from employee stock awards	—	(10.5 )
Deferred income taxes	160.3	92.0
Inventory and land option charges	42.8	19.9
Gain on sale of assets	(14.5)	)
Changes in operating assets and liabilities:		
Increase in construction in progress and finished homes	(590.6)	) (870.9 )
Increase in residential land and lots – developed, under development, held for development and held for sale	(359.8)	) (352.2 )
Increase in other assets	(34.6)	) (29.5 )
(Increase) decrease in mortgage loans held for sale	(92.4)	) 26.2
Increase in accounts payable, accrued expenses and other liabilities	105.6	129.5
Net cash provided by (used in) operating activities	306.5	(185.7 )
<b>INVESTING ACTIVITIES</b>		
Expenditures for property and equipment	(110.1)	) (103.5 )
Proceeds from sale of assets	261.1	—
Increase in restricted cash	(42.2)	) (9.9 )
Investment in unconsolidated entities	(0.1)	)
Return of investment in unconsolidated entities	15.5	—
Net principal (increase) decrease of other mortgage loans and real estate owned	(0.8)	) 5.3
Purchases of debt securities collateralized by residential real estate	—	(8.8 )
Payments related to business acquisitions, net of cash acquired	(158.1)	) (4.1 )
Net cash used in investing activities	(34.7)	) (121.0 )
<b>FINANCING ACTIVITIES</b>		
Proceeds from notes payable	2,164.3	700.0
Repayment of notes payable	(2,179.5)	) (1,051.4
Advances on mortgage repurchase facility, net	106.3	0.4
Proceeds from stock associated with certain employee benefit plans	36.2	34.3
Excess income tax benefit from employee stock awards	—	10.5
Cash paid for shares withheld for taxes	(10.3)	) (5.1 )
Cash dividends paid	(141.3)	) (112.2 )
Repurchases of common stock	(74.9)	) (60.6 )
Distributions to noncontrolling interests, net	(2.2)	)

Net cash used in financing activities	(101.4 )	(484.1 )
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>170.4</b>	<b>(790.8 )</b>
Cash and cash equivalents at beginning of period	1,007.8	1,303.2
Cash and cash equivalents at end of period	\$1,178.2	\$512.4
Supplemental disclosures of non-cash activities:		
Notes payable issued for inventory	\$—	\$4.5
Stock issued under employee incentive plans	\$63.7	\$31.8

See accompanying notes to consolidated financial statements.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
June 30, 2018

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited, consolidated financial statements include the accounts of D.R. Horton, Inc. and all of its 100% owned, majority-owned and controlled subsidiaries, which are collectively referred to as the Company, unless the context otherwise requires. Noncontrolling interests represent the proportionate equity interests in consolidated entities that are not 100% owned by the Company. The Company owns a 75% controlling interest in Forestar Group Inc. (Forestar) and therefore is required to consolidate 100% of Forestar within its consolidated financial statements, and the 25% interest the Company does not own is accounted for as noncontrolling interests. The Company's investment in unconsolidated entities in which significant influence, but not control, is held is accounted for by the equity method of accounting. All intercompany accounts, transactions and balances have been eliminated in consolidation.

The 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. In the opinion of management, these financial statements reflect all adjustments considered necessary to fairly state the results for the interim periods shown, including normal recurring accruals and other items. These financial statements, including the consolidated balance sheet as of September 30, 2017, which was derived from audited financial statements, do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2017.

Change in Presentation and Reclassifications

Certain reclassifications have been made to conform to the current year's presentation. The Company has changed the presentation of the consolidated balance sheets and statements of operations to present its homebuilding, land development, financial services and other operations on a combined basis. Prior year amounts have also been combined to reflect this presentation. Of the \$56.7 million accounts payable and other liabilities in financial services and other operations at September 30, 2017, \$4.8 million is classified as accounts payable and \$51.9 million is classified as accrued expenses and other liabilities under the new presentation. See Note B for detailed financial information for the Company's reporting segments.

Additionally, as a result of the adoption of ASU 2016-09 on October 1, 2017, \$5.1 million of cash paid for shares withheld for taxes on stock-based awards was reclassified from operating cash flows to financing cash flows in the consolidated statement of cash flows for the nine months ended June 30, 2017. These reclassifications had no effect on the Company's consolidated financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions 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 materially from those estimates.

Seasonality

Historically, the homebuilding industry has experienced seasonal fluctuations; therefore, the operating results for the three and nine months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2018 or subsequent periods.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

### Business Acquisition

On October 5, 2017, the Company acquired 75% of the outstanding shares of Forestar for \$558.3 million in cash, pursuant to the terms of the merger agreement entered into in June 2017 (the acquisition). Forestar was and continues to be a publicly traded residential and real estate development company with operations currently in 20 markets and 11 states.

The Company's alignment with Forestar advances its strategy of increasing its access to optioned land and lot positions to enhance operational efficiency and returns. Both companies are identifying land development opportunities to expand Forestar's platform, and the Company plans to acquire a large portion of finished lots from Forestar in accordance with the master supply agreement between the two companies. As the controlling shareholder of Forestar, the Company has significant influence in guiding the strategic direction and operations of Forestar.

The Company hired a valuation firm to assist in the allocation of the purchase price to Forestar's assets and liabilities. The fair values of inventories and the investment in unconsolidated entities were determined by discounting the expected future cash flows using discount rates of approximately 16% to 22% or based on contract prices from third parties. The fair values of inventories and the investment in unconsolidated entities utilized significant inputs not observable in the market, and thus represent Level 3 measurements within the fair value hierarchy. The fair value of noncontrolling interests was based on valuing the Forestar shares that were not purchased by the Company at the weighted average stock price of Forestar on the acquisition date, which is a Level 1 measurement. The fair value of notes payable was based on quoted market prices, which is a Level 2 measurement. The fair values of other assets and liabilities primarily approximate carrying value due to their short-term nature, which is a Level 1 measurement.

The purchase price was allocated based on the estimated fair value of 100% of Forestar's assets and liabilities, as follows (in millions):

Cash	\$401.9
Inventories	334.6
Investment in unconsolidated entities	98.5
Other assets	51.6
Goodwill	29.2
Total assets	915.8
Accounts payable	2.8
Accrued expenses and other liabilities	49.4
Notes payable	130.1
Total liabilities	182.3
Less: Noncontrolling interests	175.2
Net assets acquired	\$558.3

As a result of the acquisition, the Company recorded \$29.2 million of goodwill, none of which is tax deductible. The goodwill relates to expected synergies from the relationship with Forestar under the master supply agreement that will

increase the Company's access to optioned land and lot positions. The transaction costs incurred by D.R. Horton related to this acquisition totaled \$7.2 million, of which \$5.3 million was incurred during the nine months ended June 30, 2018 and expensed to selling, general and administrative expense.

7

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Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

The following unaudited pro forma data presents consolidated pro forma information as if the acquisition had been completed on October 1, 2016. The unaudited pro forma results include adjustments for interest expense and other acquisition related costs and their related income tax effects. This pro forma data should not be considered indicative of the results that would have actually occurred if the acquisition had been consummated on October 1, 2016 or of future results.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
	(In millions, except per share data)			
Revenues	\$4,435.3	\$3,804.4	\$11,562.9	\$10,046.7
Net income attributable to D.R. Horton, Inc.	\$453.8	\$288.5	\$997.5	\$775.7
Diluted net income per common share attributable to D.R. Horton, Inc.	\$1.18	\$0.76	\$2.60	\$2.05

## Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, “Revenue from Contracts with Customers,” which is a comprehensive new revenue recognition model that will replace most existing revenue recognition guidance. The core principle of this guidance is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. The guidance is effective for the Company beginning October 1, 2018 and allows for full retrospective or modified retrospective methods of adoption. The Company plans to adopt this standard using the modified retrospective method. Upon adoption of the standard, the Company expects to record an adjustment to increase retained earnings and recognize a contract asset for expected future insurance brokerage commission renewals. The Company has not yet determined the amount of this adjustment and is continuing to evaluate other effects of the standard.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities,” which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The guidance is effective for the Company beginning October 1, 2018 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, “Leases,” which requires that lease assets and liabilities be recognized on the balance sheet and that key information about leasing arrangements be disclosed. The guidance is effective for the Company beginning October 1, 2019, although early adoption is permitted. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses,” which replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information in determining credit loss estimates. The guidance is effective for the Company beginning October 1, 2020 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments," which amends and clarifies the current guidance to reduce diversity in practice of the classification of certain cash receipts and payments in the statement of cash flows. The guidance is effective for the Company beginning October 1, 2018 and is not expected to have a material impact on its consolidated statements of cash flows.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

In October 2016, the FASB issued ASU 2016-16, “Income Taxes - Intra-Entity Transfers of Assets Other Than Inventory,” which requires companies to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The guidance is effective for the Company beginning October 1, 2018 and is not expected to have a material impact on its consolidated financial position or cash flows.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows - Restricted Cash,” which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The guidance is effective for the Company beginning October 1, 2018 and is not expected to have a material impact on its consolidated financial position or cash flows.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations - Clarifying the Definition of a Business,” which clarifies the definition of a business for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. As permitted, the Company elected to early adopt this guidance in the current quarter. The adoption of this guidance did not have a material impact on its consolidated financial position, results of operations or cash flows.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other.” The guidance simplifies the measurement of goodwill impairment by removing the second step of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. Under the new guidance, goodwill impairment is measured as the amount by which a reporting unit’s carrying amount exceeds its fair value with the loss recognized limited to the total amount of goodwill allocated to the reporting unit. The guidance is effective for the Company beginning October 1, 2020 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2017, the FASB issued ASU 2017-05, “Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets,” which updates the definition of an in substance nonfinancial asset and clarifies the derecognition guidance for nonfinancial assets to conform to the new revenue recognition standard (ASU 2014-09). The guidance is effective for the Company beginning October 1, 2018, concurrent with the adoption of ASU 2014-09, as required. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In May 2017, the FASB issued ASU 2017-09, “Compensation - Stock Compensation: Scope of Modification Accounting,” which clarifies which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Under the new guidance, modification accounting is required if the fair value, vesting conditions or classification (equity or liability) of the new award are different from the original award immediately before the original award is modified. The guidance is effective for the Company beginning October 1, 2018 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.



Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE B – SEGMENT INFORMATION

The Company is a national homebuilder that is primarily engaged in the acquisition and development of land and the construction and sale of residential homes, with operations in 80 markets in 26 states across the United States. The Company's operating segments are its 44 homebuilding divisions, its majority-owned Forestar land development operations, its financial services operations and its other business activities. The homebuilding operating segments are aggregated into six reporting segments, as shown below. The Company's reporting segments are its homebuilding reporting segments, its Forestar land development segment and its financial services segment.

The Company's homebuilding divisions design, build and sell single-family detached homes on lots they develop and on fully developed lots purchased ready for home construction. To a lesser extent, the homebuilding divisions also build and sell attached homes, such as townhomes, duplexes, triplexes and condominiums. The homebuilding divisions generate most of their revenues from the sale of homes, with a lesser amount from the sale of land and lots. The Company's reportable homebuilding segments are: East, Midwest, Southeast, South Central, Southwest and West. These reporting segments have homebuilding operations located in the following states:

East:	Delaware, Georgia (Savannah only), Maryland, New Jersey, North Carolina, Pennsylvania, South Carolina and Virginia
Midwest:	Colorado, Illinois and Minnesota
Southeast:	Alabama, Florida, Georgia, Mississippi and Tennessee
South Central:	Louisiana, Oklahoma and Texas
Southwest:	Arizona and New Mexico
West:	California, Hawaii, Nevada, Oregon, Utah and Washington

The Forestar land development segment has operations in 20 markets and 11 states, where it owns, directly or through joint ventures, interests in residential and mixed-use projects. The Company's homebuilding divisions and Forestar are currently identifying land development opportunities to expand Forestar's platform, and the homebuilding divisions expect to acquire finished lots from Forestar in accordance with the master supply agreement. Forestar's segment results are presented on their historical cost basis, consistent with the manner in which management evaluates segment performance.

The Company's financial services segment provides mortgage financing and title agency services to homebuyers in many of the Company's homebuilding markets. The segment generates the substantial majority of its revenues from originating and selling mortgages and collecting fees for title insurance agency and closing services. The Company sells substantially all of the mortgages it originates and the related servicing rights to third-party purchasers.

In addition to its core homebuilding, land development and financial services operations, the Company has subsidiaries that engage in other business activities. These subsidiaries conduct insurance-related operations, construct and own income-producing rental properties, own non-residential real estate including ranch land and improvements and own and operate oil and gas related assets. One of these subsidiaries, DHI Communities, is developing and constructing multi-family rental properties on land parcels the Company already owned and currently has five projects under active construction and one project that is substantially complete. At June 30, 2018 and September 30, 2017,

property and equipment in the consolidated balance sheets included \$152.0 million and \$93.7 million, respectively, of costs incurred by DHI Communities. The operating results of these subsidiaries are immaterial for separate reporting and therefore are grouped together and presented as other.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

The accounting policies of the reporting segments are described throughout Note A included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2017. Financial information relating to the Company's reporting segments is as follows:

	June 30, 2018						
	Homebuilding	Forestar (1)	Financial Services (2)	Other	Eliminations (3)	Other Adjustments (4)	Consolidated
	(In millions)						
<b>Assets</b>							
Cash and cash equivalents	\$748.0	\$367.7	\$43.1	\$19.4	\$—	\$—	\$1,178.2
Restricted cash	11.2	40.0	7.5	—	—	—	58.7
<b>Inventories:</b>							
Construction in progress and finished homes	5,194.8	—	—	—	—	—	5,194.8
Residential land and lots — developed and under development	4,590.1	325.9	—	—	0.4	31.8	4,948.2
Land held for development	82.1	34.9	—	—	—	—	117.0
Land held for sale	43.3	—	—	—	—	—	43.3
	9,910.3	360.8	—	—	0.4	31.8	10,303.3
Investment in unconsolidated entities	—	18.0	—	—	—	14.2	32.2
Mortgage loans held for sale	—	—	679.9	—	—	—	679.9
Deferred income taxes, net	203.2	1.3	—	—	—	0.1	204.6
Property and equipment, net	205.5	1.8	3.0	174.9	—	—	385.2
Other assets	594.2	21.2	44.0	3.4	(39.5)	18.8	642.1
Goodwill	80.0	—	—	—	—	29.2	109.2
	\$11,752.4	\$810.8	\$777.5	\$197.7	\$(39.1)	\$94.1	\$13,593.4
<b>Liabilities</b>							
Accounts payable	\$641.8	\$7.4	\$3.9	\$5.4	\$(3.2)	\$—	\$655.3
Accrued expenses and other liabilities	1,007.6	72.8	38.9	12.8	(36.7)	(20.8)	1,074.6
Notes payable	2,447.1	110.5	526.3	—	—	9.7	3,093.6
	\$4,096.5	\$190.7	\$569.1	\$18.2	\$(39.9)	\$(11.1)	\$4,823.5

Amounts are presented on Forestar's historical cost basis, consistent with the manner in which management (1) evaluates segment performance. All purchase accounting adjustments are included in the Other Adjustments column.

(2) Amounts represent the aggregate balances of certain subsidiaries that are immaterial for separate reporting.

(3) Amounts represent the elimination of intercompany transactions with Forestar and the reclassification of Forestar interest expense to inventory.

(4) Amounts represent purchase accounting adjustments related to the Forestar acquisition.



Table of Contents

## D.R. HORTON, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)

June 30, 2018

	September 30, 2017			Consolidated
	Homebuilding	Financial Services	Other (1)	
	(In millions)			
<b>Assets</b>				
Cash and cash equivalents	\$973.0	\$ 24.1	\$10.7	\$ 1,007.8
Restricted cash	9.3	7.2	—	16.5
<b>Inventories:</b>				
Construction in progress and finished homes	4,606.0	—	—	4,606.0
Residential land and lots — developed and under development	4,519.7	—	—	4,519.7
Land held for development	101.0	—	—	101.0
Land held for sale	10.4	—	—	10.4
	9,237.1	—	—	9,237.1
Mortgage loans held for sale	—	587.3	—	587.3
Deferred income taxes, net	365.0	—	—	365.0
Property and equipment, net	194.4	3.0	127.6	325.0
Other assets	518.7	42.2	5.0	565.9
Goodwill	80.0	—	—	80.0
	\$11,377.5	\$ 663.8	\$143.3	\$ 12,184.6
<b>Liabilities</b>				
Accounts payable	\$575.6	\$ 1.5	\$3.3	\$ 580.4
Accrued expenses and other liabilities	933.1	35.6	16.3	985.0
Notes payable	2,451.6	420.0	—	2,871.6
	\$3,960.3	\$ 457.1	\$19.6	\$ 4,437.0

(1) Amounts represent the aggregate balances of certain subsidiaries that are immaterial for separate reporting.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

	Three Months Ended June 30, 2018						
	Homebuilding (1)	Forestar (1)	Financial Services	Other (2)	Eliminations (3)	Other Adjustments (4)	Consolidated
	(In millions)						
Revenues:							
Home sales	\$4,265.5	\$—	\$—	\$—	\$—	\$—	\$ 4,265.5
Land/lot sales and other	59.1	23.6	—	—	(8.8)	(1.2)	72.7
Financial services	—	—	97.1	—	—	—	97.1
	4,324.6	23.6	97.1	—	(8.8)	(1.2)	4,435.3
Cost of sales:							
Home sales	3,332.8	—	—	—	—	—	3,332.8
Land/lot sales and other	45.4	10.0	—	—	(5.6)	5.7	55.5
Inventory and land option charges	8.9	—	—	—	—	—	8.9
	3,387.1	10.0	—	—	(5.6)	5.7	3,397.2
Selling, general and administrative expense	349.1	6.5	71.1	8.1	—	0.1	434.9
Equity in earnings of unconsolidated entities	—	(1.0)	—	—	—	0.6	(0.4)
Gain on sale of assets	—	(1.3)	—	—	—	1.3	—
Interest expense	—	1.6	—	—	(1.6)	—	—
Other (income) expense	(1.3)	(2.7)	(4.3)	(5.0)	—	0.7	(12.6)
Income (loss) before income taxes	\$589.7	\$ 10.5	\$ 30.3	\$(3.1)	\$ (1.6)	\$ (9.6)	\$ 616.2

(1) Results are presented on Forestar's historical cost basis, consistent with the manner in which management evaluates segment performance. All purchase accounting adjustments are included in the Other Adjustments column.

(2) Amounts represent the aggregate results of certain subsidiaries that are immaterial for separate reporting.

(3) Amounts represent the elimination of intercompany transactions with Forestar and the reclassification of Forestar interest expense to inventory.

(4) Amounts represent purchase accounting adjustments related to the Forestar acquisition.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

	Nine Months Ended June 30, 2018						
	Homebuilding	Forestar (†)	Financial Services	Other (2)	Eliminations (3)	Other Adjustments (4)	Consolidated
	(In millions)						
Revenues:							
Home sales	\$ 11,122.1	\$—	\$—	\$—	\$ —	\$ —	\$ 11,122.1
Land/lot sales and other	109.2	77.0	—	—	(17.3 )	(1.2 )	167.7
Financial services	—	—	273.1	—	—	—	273.1
	11,231.3	77.0	273.1	—	(17.3 )	(1.2 )	11,562.9
Cost of sales:							
Home sales	8,761.7	—	—	—	—	—	8,761.7
Land/lot sales and other	88.7	45.5	—	—	(12.3 )	12.6	134.5
Inventory and land option charges	42.8	—	—	—	—	—	42.8
	8,893.2	45.5	—	—	(12.3 )	12.6	8,939.0
Selling, general and administrative expense	976.6	25.6	199.6	17.8	—	0.3	1,219.9
Equity in earnings of unconsolidated entities	—	(10.1 )	—	—	—	7.0	(3.1 )
Gain on sale of assets	(13.4 )	(4.0 )	—	—	—	2.9	(14.5 )
Interest expense	—	5.8	—	—	(5.8 )	—	—
Other (income) expense	(4.6 )	(4.9 )	(10.5 )	(11.4 )	—	0.7	(30.7 )
Income (loss) before income taxes	\$ 1,379.5	\$ 19.1	\$ 84.0	\$(6.4)	\$ 0.8	\$ (24.7 )	\$ 1,452.3
Summary Cash Flow Information:							
Depreciation and amortization	\$39.8	\$0.2	\$ 1.0	\$5.2	\$ —	\$ 0.4	\$46.6
Cash provided by (used in) operating activities	\$565.2	\$(219.2)	\$(27.0 )	\$(4.4)	\$ —	\$ (8.1 )	\$ 306.5

Results are presented from the date of acquisition and on Forestar's historical cost basis, consistent with the manner (1) in which management evaluates segment performance. All purchase accounting adjustments are included in the Other Adjustments column.

(2) Amounts represent the aggregate results of certain subsidiaries that are immaterial for separate reporting.

(3) Amounts represent the elimination of intercompany transactions with Forestar and the reclassification of Forestar interest expense to inventory.

(4) Amounts represent purchase accounting adjustments related to the Forestar acquisition.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

	Three Months Ended June 30, 2017			
	Homebuilding	Financial Services	Other (1)	Consolidated
	(In millions)			
<b>Revenues:</b>				
Home sales	\$3,662.3	\$ —	\$ —	\$ 3,662.3
Land/lot sales and other	22.2	—	—	22.2
Financial services	—	91.9	—	91.9
	3,684.5	91.9	—	3,776.4
<b>Cost of sales:</b>				
Home sales	2,936.9	—	—	2,936.9
Land/lot sales and other	18.8	—	—	18.8
Inventory and land option charges	5.4	—	—	5.4
	2,961.1	—	—	2,961.1
Selling, general and administrative expense	309.5	62.1	2.9	374.5
Other (income) expense	(1.3 )	(4.1 )	1.7	(3.7 )
Income (loss) before income taxes	\$415.2	\$ 33.9	\$(4.6)	\$ 444.5
	Nine Months Ended June 30, 2017			
	Homebuilding	Financial Services	Other (1)	Consolidated
	(In millions)			
<b>Revenues:</b>				
Home sales	\$9,618.1	\$ —	\$ —	\$ 9,618.1
Land/lot sales and other	56.9	—	—	56.9
Financial services	—	256.9	—	256.9
	9,675.0	256.9	—	9,931.9
<b>Cost of sales:</b>				
Home sales	7,713.8	—	—	7,713.8
Land/lot sales and other	45.2	—	—	45.2
Inventory and land option charges	19.9	—	—	19.9
	7,778.9	—	—	7,778.9
Selling, general and administrative expense	872.4	175.0	8.1	1,055.5
Other (income) expense	(7.8 )	(10.8 )	(0.4 )	(19.0 )
Income (loss) before income taxes	\$1,031.5	\$ 92.7	\$(7.7)	\$ 1,116.5
<b>Summary Cash Flow Information:</b>				
Depreciation and amortization	\$36.8	\$ 1.0	\$2.6	\$ 40.4
Cash (used in) provided by operating activities	\$(259.6 )	\$ 76.9	\$(3.0)	\$(185.7 )

(1) Amounts represent the aggregate results of certain subsidiaries that are immaterial for separate reporting.



Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

Homebuilding Inventories by Reporting Segment (1)	June 30, September 30,	
	2018	2017
	(In millions)	
East	\$1,211.3	\$ 1,068.9
Midwest	540.3	492.6
Southeast	2,652.2	2,392.3
South Central	2,407.9	2,199.4
Southwest	527.5	506.1
West	2,346.1	2,352.5
Corporate and unallocated (2)	225.0	225.3
	\$9,910.3	\$ 9,237.1

(1) Homebuilding inventories are the only assets included in the measure of homebuilding segment assets used by the Company's chief operating decision makers.

(2) Corporate and unallocated consists primarily of capitalized interest and property taxes.

Homebuilding Results by Reporting Segment	Three Months Ended		Nine Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(In millions)			
Revenues				
East	\$529.1	\$482.2	\$1,357.9	\$1,160.7
Midwest	256.7	202.2	621.7	522.0
Southeast	1,263.3	1,136.3	3,293.9	2,988.7
South Central	1,005.4	924.8	2,733.2	2,497.1
Southwest	220.1	152.6	548.6	387.8
West	1,050.0	786.4	2,676.0	2,118.7
	\$4,324.6	\$3,684.5	\$11,231.3	\$9,675.0
Inventory and Land Option Charges (1)				
East	\$0.3	\$0.5	\$0.9	\$7.0
Midwest	4.3	1.3	4.7	1.6
Southeast	1.1	2.3	27.3	3.9
South Central	1.5	0.4	3.5	2.3
Southwest	—	—	0.8	0.1
West	1.7	0.9	5.6	5.0
	\$8.9	\$5.4	\$42.8	\$19.9
Income before Income Taxes (2)				
East	\$67.1	\$54.2	\$158.7	\$106.4
Midwest	23.0	17.9	55.0	28.8
Southeast	156.1	128.6	374.9	341.3

South Central	143.3	119.1	365.2	321.4
Southwest	32.3	14.8	69.1	26.0
West	167.9	80.6	356.6	207.6
	\$589.7	\$415.2	\$1,379.5	\$1,031.5

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(1) To conform to the current year presentation, prior period amounts include earnest money and pre-acquisition cost write-offs.

Expenses maintained at the corporate level consist primarily of interest and property taxes, which are capitalized and amortized to cost of sales or expensed directly, and the expenses related to operating the Company's corporate (2) office. The amortization of capitalized interest and property taxes is allocated to each segment based on the segment's cost of sales, while expenses associated with the corporate office are allocated to each segment based on the segment's inventory balances.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

NOTE C – INVENTORIES

At June 30, 2018, the Company reviewed the performance and outlook for all of its communities and land inventories for indicators of potential impairment and performed detailed impairment evaluations and analyses when necessary. The Company performed detailed impairment evaluations of communities and land inventories with a combined carrying value of \$65.3 million and recorded impairment charges of \$3.9 million during the three months ended June 30, 2018 to reduce the carrying value of an impaired community to fair value. During the nine months ended June 30, 2018, impairment charges totaled \$8.3 million. There were \$1.0 million and \$10.4 million of impairment charges recorded in the three and nine months ended June 30, 2017, respectively. Inventory impairments and the land option charges discussed below are included in cost of sales in the consolidated statements of operations.

During the three and nine months ended June 30, 2018, the Company wrote off \$5.0 million and \$10.0 million, respectively, of earnest money deposits and pre-acquisition costs related to land option contracts that the Company has terminated or expects to terminate. Inventory and land option charges for the nine months ended June 30, 2018 also include a charge of \$24.5 million related to the settlement of an outstanding dispute associated with a land transaction. Earnest money and pre-acquisition cost write-offs for the three and nine months ended June 30, 2017 were \$4.4 million and \$9.5 million, respectively.

On February 8, 2018, the Forestar land development segment sold a portion of its assets for \$232 million. This strategic asset sale included projects owned both directly and indirectly through ventures. The total net proceeds after certain purchase price adjustments, closing costs and other costs associated with selling these projects was \$217.5 million, and a gain on the sale of these assets of \$0.7 million is included in the Company's consolidated statement of operations for the nine months ended June 30, 2018.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE D – NOTES PAYABLE

The Company's notes payable at their principal amounts, net of unamortized discounts and debt issuance costs, consist of the following:

	June 30, 2018	September 30, 2017
	(In millions)	
Homebuilding:		
Unsecured:		
Revolving credit facility, maturing 2022	\$—	\$ —
3.625% senior notes due 2018	—	399.7
3.75% senior notes due 2019	499.4	498.8
4.0% senior notes due 2020	498.6	497.9
2.55% senior notes due 2020	397.8	—
4.375% senior notes due 2022	348.3	348.1
4.75% senior notes due 2023	298.6	298.4
5.75% senior notes due 2023	397.9	397.6
Other secured notes	6.5	11.1
	2,447.1	2,451.6
Forestar:		
Unsecured:		
3.75% convertible senior notes due 2020	120.2	
	120.2	
Financial Services:		
Mortgage repurchase facility, maturing 2019	526.3	420.0
	\$3,093.6	\$ 2,871.6

Debt issuance costs that were deducted from the carrying amounts of the homebuilding senior notes totaled \$9.3 million and \$9.5 million at June 30, 2018 and September 30, 2017, respectively. These costs are capitalized into inventory as they are amortized. Forestar's 3.75% convertible senior notes due 2020 include an unamortized fair value adjustment of \$9.7 million at June 30, 2018.

## Homebuilding:

The Company has a \$1.275 billion senior unsecured revolving credit facility with an uncommitted accordion feature that could increase the size of the facility to \$1.9 billion, subject to certain conditions and availability of additional bank commitments. The facility also provides for the issuance of letters of credit with a sublimit equal to approximately 50% of the revolving credit commitment. Letters of credit issued under the facility reduce the available borrowing capacity. The interest rate on borrowings under the revolving credit facility may be based on either the Prime Rate or London Interbank Offered Rate (LIBOR) plus an applicable margin, as defined in the credit agreement governing the facility. The maturity date of the facility is September 25, 2022. Borrowings and repayments under the facility totaled \$1.8 billion each during the nine months ended June 30, 2018. At June 30, 2018, there were no

borrowings outstanding and \$87.1 million of letters of credit issued under the revolving credit facility.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

The Company's revolving credit facility imposes restrictions on its operations and activities, including requiring the maintenance of a maximum allowable ratio of debt to tangible net worth and a borrowing base restriction if the Company's ratio of debt to tangible net worth exceeds a certain level. These covenants are measured as defined in the credit agreement governing the facility and are reported to the lenders quarterly. A failure to comply with these financial covenants could allow the lending banks to terminate the availability of funds under the revolving credit facility or cause any outstanding borrowings to become due and payable prior to maturity. The credit agreement governing the facility and the indenture governing the senior notes also impose restrictions on the creation of secured debt and liens. At June 30, 2018, the Company was in compliance with all of the covenants, limitations and restrictions of its revolving credit facility and public debt obligations.

The Company has an automatically effective universal shelf registration statement filed with the Securities and Exchange Commission (SEC) in August 2015, registering debt and equity securities that the Company may issue from time to time in amounts to be determined.

In December 2017, the Company issued \$400 million principal amount of 2.55% senior notes due December 1, 2020, with interest payable semi-annually. The notes represent unsecured obligations of the Company. The annual effective interest rate of these notes after giving effect to the amortization of financing costs is 2.8%. In December 2017, the Company redeemed \$400 million principal amount of its 3.625% senior notes due February 2018. The senior notes were redeemed at a price equal to 100% of the principal amount of the notes, together with accrued and unpaid interest.

Effective August 1, 2017, the Board of Directors authorized the repurchase of up to \$500 million of the Company's debt securities effective through July 31, 2018. All of the \$500 million authorization was remaining at June 30, 2018. In July 2018, the Board of Directors authorized the repurchase of up to \$500 million of the Company's debt securities effective through September 30, 2019, which replaced the previous authorization.

Forestar:

On October 5, 2017, Forestar terminated its \$50 million senior credit facility. The \$50 million senior credit facility included a \$50 million sublimit for letters of credit. Also on October 5, 2017, Forestar entered into a new agreement providing for a \$30 million secured standby letter of credit facility, secured by \$40 million in cash, which is included in restricted cash in the consolidated balance sheet. At June 30, 2018, letters of credit outstanding under the new facility totaled \$21.5 million. Forestar is currently pursuing a new revolving credit facility to support future growth.

On October 5, 2017, Forestar had \$120 million principal amount of 3.75% convertible senior notes due 2020. The completion of the acquisition resulted in a fundamental change in the notes as described in the related note indentures and as a result, Forestar offered to purchase all or any part of every holder's convertible senior notes for a price in cash equal to 100% of the aggregate principal amount of the notes, plus accrued and unpaid interest, if any, to the date of repurchase. As a result, Forestar purchased \$1.1 million of the aggregate principal amount of the notes. Also, prior to the acquisition, upon conversion of the notes each holder was entitled to receive 40.8351 shares of former Forestar common stock per \$1,000 principal amount of notes surrendered for conversion. In connection with the acquisition, the conversion ratio was adjusted in accordance with the indenture governing the convertible notes such that each

holder is now entitled to receive \$579.77062 in cash and 8.17192 shares of new Forestar common stock per \$1,000 principal amount of notes surrendered for conversion. The convertible senior notes are not guaranteed by D.R. Horton, Inc. or any of the subsidiaries that guarantee the Company's homebuilding debt.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)

June 30, 2018

Financial Services:

The Company's mortgage subsidiary, DHI Mortgage, has a mortgage repurchase facility that is accounted for as a secured financing. The mortgage repurchase facility provides financing and liquidity to DHI Mortgage by facilitating purchase transactions in which DHI Mortgage transfers eligible loans to the counterparties against the transfer of funds by the counterparties, thereby becoming purchased loans. DHI Mortgage then has the right and obligation to repurchase the purchased loans upon their sale to third-party purchasers in the secondary market or within specified time frames from 45 to 60 days in accordance with the terms of the mortgage repurchase facility. The total capacity of the facility is \$600 million; however, the capacity increases, without requiring additional commitments, to \$725 million for approximately 30 days at each quarter end and to \$800 million for approximately 45 days at fiscal year end. The capacity of the facility can also be increased to \$1.0 billion subject to the availability of additional commitments. The maturity date of the facility is February 22, 2019.

As of June 30, 2018, \$639.4 million of mortgage loans held for sale with a collateral value of \$619.8 million were pledged under the mortgage repurchase facility. As a result of advance paydowns totaling \$93.5 million, DHI Mortgage had an obligation of \$526.3 million outstanding under the mortgage repurchase facility at June 30, 2018 at a 3.9% annual interest rate.

The mortgage repurchase facility is not guaranteed by D.R. Horton, Inc. or any of the subsidiaries that guarantee the Company's homebuilding debt. The facility contains financial covenants as to the mortgage subsidiary's minimum required tangible net worth, its maximum allowable ratio of debt to tangible net worth and its minimum required liquidity. These covenants are measured and reported to the lenders monthly. At June 30, 2018, DHI Mortgage was in compliance with all of the conditions and covenants of the mortgage repurchase facility.

In the past, DHI Mortgage has been able to renew or extend its mortgage credit facility at a sufficient capacity and on satisfactory terms prior to its maturity and obtain temporary additional commitments through amendments to the credit facility during periods of higher than normal volumes of mortgages held for sale. The liquidity of the Company's financial services business depends upon its continued ability to renew and extend the mortgage repurchase facility or to obtain other additional financing in sufficient capacities.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE E – CAPITALIZED INTEREST

The Company capitalizes interest costs incurred to inventory during active development and construction (active inventory). Capitalized interest is charged to cost of sales as the related inventory is delivered to the buyer. During periods in which the Company's active inventory is lower than its debt level, a portion of the interest incurred is reflected as interest expense in the period incurred. During the first nine months of fiscal 2018 and fiscal 2017, the Company's active inventory exceeded its debt level, and all interest incurred was capitalized to inventory.

The following table summarizes the Company's interest costs incurred, capitalized and expensed during the three and nine months ended June 30, 2018 and 2017:

	Three Months Ended June 30, 2018		Nine Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In millions)			
Capitalized interest, beginning of period	\$170.1	\$186.2	\$167.9	\$191.2
Interest incurred (1)	31.0	32.4	93.8	99.4
Interest charged to cost of sales	(35.4 )	(38.7 )	(96.0 )	(110.7 )
Capitalized interest, end of period	\$165.7	\$179.9	\$165.7	\$179.9

(1) Interest incurred included interest on the Company's mortgage repurchase facility of \$3.4 million and \$7.9 million in the three and nine months ended June 30, 2018, respectively, and \$2.4 million and \$5.9 million in the same periods of fiscal 2017. Also included in the fiscal 2018 amounts is interest incurred by Forestar of \$0.9 million in the three months ended June 30, 2018 and \$2.3 million from the acquisition date through June 30, 2018.

## NOTE F – MORTGAGE LOANS

## Mortgage Loans Held for Sale

Mortgage loans held for sale consist primarily of single-family residential loans collateralized by the underlying property. At June 30, 2018, mortgage loans held for sale had an aggregate carrying value of \$679.9 million and an aggregate outstanding principal balance of \$659.2 million. At September 30, 2017, mortgage loans held for sale had an aggregate carrying value of \$587.3 million and an aggregate outstanding principal balance of \$570.8 million. During the nine months ended June 30, 2018 and 2017, mortgage loans originated totaled \$5.5 billion and \$4.8 billion, respectively, and mortgage loans sold totaled \$5.4 billion and \$4.8 billion, respectively. The Company had gains on sales of loans and servicing rights of \$68.0 million and \$193.7 million during the three and nine months ended June 30, 2018, respectively, compared to \$65.0 million and \$185.9 million in the prior year periods. Net gains on sales of loans and servicing rights are included in revenues in the consolidated statements of operations. Approximately 93% of the mortgage loans sold by DHI Mortgage during the nine months ended June 30, 2018 were sold to four major financial entities, one of which purchased 38% of the total loans sold.

To manage the interest rate risk inherent in its mortgage operations, the Company hedges its risk using derivative instruments, generally forward sales of mortgage-backed securities (MBS), which are referred to as “hedging instruments” in the following discussion. The Company does not enter into or hold derivatives for trading or speculative purposes.

Table of Contents

## D.R. HORTON, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)

June 30, 2018

Newly originated loans that have been closed but not committed to third-party purchasers are hedged to mitigate the risk of changes in their fair value. Hedged loans are committed to third-party purchasers typically within three days after origination. The notional amounts of the hedging instruments used to hedge mortgage loans held for sale vary in relationship to the underlying loan amounts, depending on the movements in the value of each hedging instrument relative to the value of the underlying mortgage loans. The fair value change related to the hedging instruments generally offsets the fair value change in the mortgage loans held for sale. The net fair value change, which for the three and nine months ended June 30, 2018 and 2017 was not significant, is recognized in revenues in the consolidated statements of operations. At June 30, 2018 and September 30, 2017, the Company's mortgage loans held for sale that were not committed to third-party purchasers totaled \$428.6 million and \$330.7 million, respectively, and the notional amounts of the hedging instruments related to those loans totaled \$428.6 million and \$330.7 million, respectively.

## Other Mortgage Loans and Loss Reserves

Mortgage loans are sold with limited recourse provisions derived from industry-standard representations and warranties in the relevant agreements. These representations and warranties primarily involve the absence of misrepresentations by the borrower or other parties, the appropriate underwriting of the loan and in some cases, a required minimum number of payments to be made by the borrower. The Company generally does not retain any other continuing interest related to mortgage loans sold in the secondary market. The majority of other mortgage loans consists of loans repurchased due to these limited recourse obligations. Typically, these loans are impaired, and some become real estate owned through the foreclosure process. At June 30, 2018 and September 30, 2017, the Company's total other mortgage loans and real estate owned, before loss reserves, were as follows:

	June 30, 2018	September 30, 2017
	(In millions)	
Other mortgage loans	\$8.6	\$ 8.3
Real estate owned	—	—
	\$8.6	\$ 8.3

The Company has recorded reserves for estimated losses on other mortgage loans and future loan repurchase obligations due to the limited recourse provisions, both of which are recorded as reductions of revenue. The loss reserve for loan repurchase and settlement obligations is estimated based on analysis of the volume of mortgages originated, loan repurchase requests received, actual repurchases and losses through the disposition of such loans or requests and discussions with mortgage purchasers. The reserve balances at June 30, 2018 and September 30, 2017 were as follows:

	June 30, 2018	September 30, 2017
	(In millions)	
Loss reserves related to:		
Other mortgage loans	\$0.9	\$ 1.0
Loan repurchase and settlement obligations – known and expected	7.0	7.7
	\$7.9	\$ 8.7

Other mortgage loans and real estate owned net of the related loss reserves are included in other assets, while loan repurchase obligations are included in accrued expenses and other liabilities in the Company's consolidated balance sheets.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

Loan Commitments and Related Derivatives

The Company is party to interest rate lock commitments (IRLCs), which are extended to borrowers who have applied for loan funding and meet defined credit and underwriting criteria. At June 30, 2018 and September 30, 2017, the notional amount of IRLCs, which are accounted for as derivative instruments recorded at fair value, totaled \$706.8 million and \$446.2 million, respectively.

The Company manages interest rate risk related to its IRLCs through the use of best-efforts whole loan delivery commitments and hedging instruments. These instruments are considered derivatives in an economic hedge and are accounted for at fair value with gains and losses recognized in revenues in the consolidated statements of operations. At June 30, 2018 and September 30, 2017, the notional amount of best-efforts whole loan delivery commitments totaled \$49.6 million and \$26.9 million, respectively, and the notional amount of hedging instruments related to IRLCs not yet committed to purchasers totaled \$610.4 million and \$389.3 million, respectively.

NOTE G – INCOME TAXES

The Company's income tax expense for the three and nine months ended June 30, 2018 was \$162.5 million and \$458.9 million, respectively, compared to \$155.5 million and \$391.4 million in the prior year periods. The effective tax rate was 26.4% and 31.6% for the three and nine months ended June 30, 2018, respectively, compared to 35.0% and 35.1% in the prior year periods. The effective tax rates for the three and nine months ended June 30, 2018 reflect the impact of the Tax Cuts and Jobs Act (Tax Act), which was enacted into law on December 22, 2017, an excess tax benefit related to stock-based compensation and the enactment of the Bipartisan Budget Act of 2018, which retroactively extended the expiration date of the federal energy efficient home credit from December 31, 2016 until December 31, 2017. The effective tax rates for all periods include an expense for state income taxes, reduced by tax benefits for the domestic production activities deduction.

The Tax Act reduced the corporate tax rate from 35% to 21% for all corporations effective January 1, 2018. For fiscal year companies, the change in law requires the application of a blended tax rate in the year of change, which for the Company is 24.5% for the fiscal year ending September 30, 2018. Thereafter, the applicable statutory tax rate is 21%. ASC 740 requires all companies to reflect the effects of the new law in the period in which the law was enacted. Accordingly, the Company reduced the statutory tax rate that applied to its year-to-date earnings from 35% to 24.5%. In addition, the Company remeasured its deferred tax assets and liabilities for the tax law change, which resulted in additional income tax expense of \$108.7 million recognized during the three months ended December 31, 2017. The initial remeasurement was the Company's best estimate based on the information available at the time. Adjustments to deferred tax expense will continue to be recognized to the extent the actual timing of future deferred tax reversals and originations differ from original estimates and will be recorded in subsequent quarters until the filing of the Company's federal tax return. Any required adjustment will be reflected as a discrete expense or benefit in the quarter that it is identified, as allowed by SEC Staff Accounting Bulletin No. 118. For the three months ended June 30, 2018, no significant adjustments to the remeasurement of the Company's deferred tax accounts were recognized. No other tax law changes as a result of the Tax Act are expected to have a significant impact on the Company's financial statements. The Company's deferred tax assets, net of deferred tax liabilities, were \$233.9 million at June 30, 2018 compared to

\$376.2 million at September 30, 2017.

On October 5, 2017, the Company acquired 75% of the outstanding shares of Forestar. The Company recorded goodwill of \$29.2 million, which is not deductible for income tax purposes. Deferred tax assets of \$20.4 million and a valuation allowance of \$20.1 million were recorded as a result of the acquisition. At the acquisition date, the Company considered whether it was more likely than not that some portion or all of Forestar's deferred tax assets would not be realized. In making such judgment, the Company considered all available positive and negative evidence. The Company determined that Forestar's cumulative losses in recent years were a significant piece of negative evidence that outweighed the positive evidence, and a valuation allowance was recorded.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

In addition to the valuation allowance relating to Forestar's deferred tax assets, the Company has a valuation allowance related to state deferred tax assets for net operating loss (NOL) carryforwards. The valuation allowance was recorded because it is more likely than not that a portion of the state NOL carryforwards will not be realized because some state NOL carryforward periods are too brief to realize the related deferred tax asset. The Company's total valuation allowance was \$29.3 million at June 30, 2018 and \$11.2 million at September 30, 2017. The Company will continue to evaluate both the positive and negative evidence in determining the need for a valuation allowance with respect to its remaining state NOL carryforwards and Forestar's deferred tax assets. Any reversal of the valuation allowance in future periods will impact the Company's effective tax rate.

The accounting for deferred taxes is based upon estimates of future results. Differences between the anticipated and actual outcomes of these future results could have a material impact on the Company's consolidated results of operations or financial position. Also, changes in existing federal and state tax laws and tax rates could affect future tax results and the valuation of the Company's deferred tax assets.

## NOTE H – EARNINGS PER SHARE

The following table sets forth the numerators and denominators used in the computation of basic and diluted earnings per share.

	Three Months Ended June 30, 2018		Nine Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In millions)			
Numerator:				
Net income attributable to D.R. Horton, Inc.	\$453.8	\$289.0	\$994.1	\$725.1
Denominator:				
Denominator for basic earnings per share — weighted average common shares	377.4	374.8	376.6	374.1
Effect of dilutive securities:				
Employee stock awards	6.0	4.6	7.0	4.4
Denominator for diluted earnings per share — adjusted weighted average common shares	383.4	379.4	383.6	378.5
Basic net income per common share attributable to D.R. Horton, Inc.	\$1.20	\$0.77	\$2.64	\$1.94
Diluted net income per common share attributable to D.R. Horton, Inc.	\$1.18	\$0.76	\$2.59	\$1.92

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

NOTE I – STOCKHOLDERS' EQUITY

The Company has an automatically effective universal shelf registration statement, filed with the SEC in August 2015, registering debt and equity securities that it may issue from time to time in amounts to be determined.

Effective August 1, 2017, the Board of Directors authorized the repurchase of up to \$200 million of the Company's common stock effective through July 31, 2018. During the nine months ended June 30, 2018, the Company repurchased 1,608,537 shares of its common stock for \$74.9 million, resulting in a remaining authorization of \$125.1 million at June 30, 2018. In July 2018, the Board of Directors authorized the repurchase of up to \$400 million of the Company's common stock effective through September 30, 2019, which replaced the previous authorization.

During the three months ended June 30, 2018, the Board of Directors approved a quarterly cash dividend of \$0.125 per common share, which was paid on May 25, 2018 to stockholders of record on May 11, 2018. In July 2018, the Board of Directors approved a quarterly cash dividend of \$0.125 per common share, payable on August 22, 2018 to stockholders of record on August 8, 2018. Cash dividends of \$0.10 per common share were approved and paid in each quarter of fiscal 2017.

NOTE J – EMPLOYEE BENEFIT PLANS

Restricted Stock Units (RSUs)

The Company's Stock Incentive Plan provides for the granting of stock options and restricted stock units to executive officers, other key employees and non-management directors. Restricted stock unit awards may be based on performance (performance-based) or on service over a requisite time period (time-based). Performance-based and time-based RSU equity awards represent the contingent right to receive one share of the Company's common stock per RSU if the vesting conditions and/or performance criteria are satisfied. The RSUs have no dividend or voting rights until vested.

In November 2017, a total of 330,000 performance-based RSU equity awards were granted to the Company's Chairman, its Chief Executive Officer and its Chief Operating Officer. These awards vest at the end of a three-year performance period ending September 30, 2020. The number of units that ultimately vest depends on the Company's relative position as compared to its peers in achieving certain performance criteria and can range from 0% to 200% of the number of units granted. The performance criteria are total shareholder return; return on investment; selling, general and administrative expense containment; and gross profit. The grant date fair value of these equity awards was \$45.79 per unit. Compensation expense related to these grants was \$1.5 million and \$4.5 million in the three and nine months ended June 30, 2018, respectively, based on the Company's performance against its peer group, the elapsed portion of the performance period and the grant date fair value of the award. Also, 40,000 time-based RSUs were granted to the Company's Chief Financial Officer in November 2017. These time-based RSUs vest annually in equal installments over a three-year period ending November 2020. The fair value of this equity award on the date of grant was \$43.46 per unit.

In March 2018, a total of 1.7 million time-based RSUs were granted to approximately 920 recipients, including the Company's executive officers, other key employees and non-management directors. The weighted average grant date fair value of these equity awards was \$41.78 per unit, and they vest annually in equal installments over periods of three to five years. Compensation expense related to these grants was \$3.6 million and \$8.4 million in the three and nine months ended June 30, 2018, respectively.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE K – COMMITMENTS AND CONTINGENCIES

## Warranty Claims

The Company provides its homebuyers with a ten-year limited warranty for major defects in structural elements such as framing components and foundation systems, a two-year limited warranty on major mechanical systems, and a one-year limited warranty on other construction components. The Company's warranty liability is based upon historical warranty cost experience in each market in which it operates and is adjusted to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built.

Changes in the Company's warranty liability during the three and nine months ended June 30, 2018 and 2017 were as follows:

	Three Months Ended June 30, 2018		Nine Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In millions)			
Warranty liability, beginning of period	\$162.6	\$112.8	\$143.7	\$104.4
Warranties issued	23.6	17.6	59.3	45.9
Changes in liability for pre-existing warranties	8.1	8.2	25.9	14.5
Settlements made	(17.9 )	(18.3 )	(52.5 )	(44.5 )
Warranty liability, end of period	\$176.4	\$120.3	\$176.4	\$120.3

## Legal Claims and Insurance

The Company is named as a defendant in various claims, complaints and other legal actions in the ordinary course of business. At any point in time, the Company is managing several hundred individual claims related to construction defect matters, personal injury claims, employment matters, land development issues, contract disputes and other matters. The Company has established reserves for these contingencies based on the estimated costs of pending claims and the estimated costs of anticipated future claims related to previously closed homes. The estimated liabilities for these contingencies were \$407.8 million and \$420.6 million at June 30, 2018 and September 30, 2017, respectively, and are included in accrued expenses and other liabilities in the consolidated balance sheets. Approximately 99% and 98% of these reserves related to construction defect matters at June 30, 2018 and September 30, 2017, respectively. Expenses related to the Company's legal contingencies were \$47.5 million and \$80.6 million in the nine months ended June 30, 2018 and 2017, respectively.

The Company's reserves for construction defect claims include the estimated costs of both known claims and anticipated future claims. As of June 30, 2018, no individual existing claim was material to the Company's financial statements. The Company has closed a significant number of homes during recent years and may be subject to future construction defect claims on these homes. Although regulations vary from state to state, construction defect issues can generally be reported for up to ten years after the home has closed in many states in which the Company operates.

Historical data and trends regarding the frequency of claims incurred and the costs to resolve claims relative to the types of products and markets where the Company operates are used to estimate the construction defect liabilities for both existing and anticipated future claims. These estimates are subject to ongoing revision as the circumstances of individual pending claims and historical data and trends change. Adjustments to estimated reserves are recorded in the accounting period in which the change in estimate occurs.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

Historical trends in construction defect claims have been inconsistent, and the Company believes they may continue to fluctuate. Housing market conditions have been volatile across most of the Company's markets over the past ten years, and the Company believes such conditions can affect the frequency and cost of construction defect claims. If the ultimate resolution of construction defect claims resulting from the Company's home closings in prior years varies from current expectations, it could significantly change the Company's estimates regarding the frequency and timing of claims incurred and the costs to resolve existing and anticipated future claims, which would impact the construction defect reserves in the future. If the frequency of claims incurred or costs of existing and future legal claims significantly exceed the Company's current estimates, they will have a significant negative impact on its future earnings and liquidity.

The Company's reserves for legal claims decreased from \$420.6 million at September 30, 2017 to \$407.8 million at June 30, 2018. The decrease in reserves is due to a decrease in known claims. Changes in the Company's legal claims reserves during the nine months ended June 30, 2018 and 2017 were as follows:

	Nine Months Ended June 30, 2018    2017 (In millions)	
Reserves for legal claims, beginning of period	\$420.6	\$423.5
Increase in reserves	47.2	86.2
Payments	(60.0 )	(56.2 )
Reserves for legal claims, end of period	\$407.8	\$453.5

The Company estimates and records receivables under its applicable insurance policies related to its estimated contingencies for known claims and anticipated future construction defect claims on previously closed homes and other legal claims and lawsuits incurred in the ordinary course of business when recovery is probable. Additionally, the Company may have the ability to recover a portion of its losses from its subcontractors and their insurance carriers when the Company has been named as an additional insured on their insurance policies. The Company's receivables related to its estimates of insurance recoveries from estimated losses for pending legal claims and anticipated future claims related to previously closed homes totaled \$56.0 million, \$74.4 million and \$82.6 million at June 30, 2018, September 30, 2017 and June 30, 2017, respectively, and are included in other assets in the consolidated balance sheets.

The estimation of losses related to these reserves and the related estimates of recoveries from insurance policies are subject to a high degree of variability due to uncertainties such as trends in construction defect claims relative to the Company's markets and the types of products built, claim frequency, claim settlement costs and patterns, insurance industry practices and legal interpretations, among others. Due to the high degree of judgment required in establishing reserves for these contingencies, actual future costs and recoveries from insurance could differ significantly from current estimated amounts, and it is not possible for the Company to make a reasonable estimate of the possible loss or range of loss in excess of its reserves.

#### Land and Lot Option Purchase Contracts

The Company enters into land and lot option purchase contracts to acquire land or lots for the construction of homes. Under these contracts, the Company will fund a stated deposit in consideration for the right, but not the obligation, to purchase land or lots at a future point in time with predetermined terms. Under the terms of many of the option purchase contracts, the option deposits are not refundable in the event the Company elects to terminate the contract. Option deposits are included in other assets in the consolidated balance sheets.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
June 30, 2018

At June 30, 2018, the Company's homebuilding segment had total option deposits of \$345.5 million, consisting of cash deposits of \$341.3 million and promissory notes and letters of credit of \$4.2 million, to purchase land and lots with a total remaining purchase price of approximately \$5.8 billion. The majority of land and lots under contract are currently expected to be purchased within three years. Of these amounts, \$38.4 million of the option deposits related to contracts with Forestar to purchase land and lots with a remaining purchase price of \$402.0 million. A limited number of the homebuilding land and lot option purchase contracts at June 30, 2018, representing \$74.8 million of remaining purchase price, were subject to specific performance provisions which may require the Company to purchase the land or lots upon the land sellers meeting their contractual obligations. Of the \$74.8 million remaining purchase price subject to specific performance provisions, \$34.7 million related to a contract between the homebuilding segment and Forestar.

At June 30, 2018, Forestar had total option deposits of \$3.9 million to purchase land and lots from third parties with a total remaining purchase price of approximately \$59.3 million.

Option purchase contracts can result in the creation of a variable interest in the entity holding the land parcel under option. There were no variable interest entities reported in the consolidated balance sheets at June 30, 2018 and September 30, 2017 because, with regard to each entity, the Company determined it did not control the activities that most significantly impact the variable interest entity's economic performance, and it did not have an obligation to absorb losses of or the right to receive benefits from the entity. The maximum exposure to losses related to the Company's variable interest entities is limited to the amounts of the Company's related option deposits. At June 30, 2018 and September 30, 2017, the option deposits related to these contracts totaled \$281.6 million and \$222.9 million, respectively.

Other Commitments

At June 30, 2018, the Company had outstanding surety bonds of \$1.3 billion and letters of credit of \$110.0 million to secure performance under various contracts. Of the total letters of credit, \$87.1 million were issued under the Company's revolving credit facility and \$21.5 million were issued under Forestar's senior credit facility. The remaining \$1.4 million of letters of credit were issued under a secured letter of credit agreement requiring the Company to deposit cash as collateral with the issuing bank, and the cash restricted for this purpose is included in restricted cash in the consolidated balance sheets.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE L – OTHER ASSETS, ACCRUED EXPENSES AND OTHER LIABILITIES

The Company's other assets at June 30, 2018 and September 30, 2017 were as follows:

	June 30, 2018	September 30, 2017 (1)
	(In millions)	
Earnest money and refundable deposits	\$386.8	\$ 312.2
Insurance receivables	56.0	74.4
Other receivables	83.8	60.0
Prepaid assets	19.0	30.8
Rental properties	38.5	52.0
Other	58.0	36.5
	\$642.1	\$ 565.9

The Company's accrued expenses and other liabilities at June 30, 2018 and September 30, 2017 were as follows:

	June 30, 2018	September 30, 2017 (1)
	(In millions)	
Reserves for legal claims	\$407.8	\$ 420.6
Employee compensation and related liabilities	211.9	197.9
Warranty liability	176.4	143.7
Accrued interest	34.9	11.9
Federal and state income tax liabilities	40.0	20.3
Inventory related accruals	28.7	24.8
Customer deposits	61.0	44.9
Accrued property taxes	25.7	33.9
Other	88.2	87.0
	\$1,074.6	\$ 985.0

(1) To conform to the current year presentation, prior period amounts have been reclassified to reflect the Company's consolidated balances, rather than the balances of its homebuilding segment that were previously presented.

Table of Contents

D.R. HORTON, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)  
 June 30, 2018

## NOTE M – INVESTMENT IN UNCONSOLIDATED ENTITIES

At June 30, 2018, the Forestar segment owned interests in 6 entities that are accounted for under the equity method of accounting. The purpose of these entities is to acquire and develop residential, multi-family and mixed-use communities. At June 30, 2018, the Company's investment in these unconsolidated entities was \$32.2 million, which included a purchase accounting adjustment of \$14.2 million. The aggregate outstanding debt of these entities was \$45.6 million, of which \$41.1 million is non-recourse to the Company.

Summarized condensed financial information on a combined 100% basis related to the Company's unconsolidated entities is as follows:

## Balance Sheet

	June 30, 2018 (In millions)
Assets:	
Cash and cash equivalents	\$ 5.8
Real estate	88.0
Other assets	1.0
Total assets	\$ 94.8
Liabilities and Equity:	
Accounts payable and other liabilities	\$ 2.0
Debt	45.6
Equity	47.2
Total liabilities and equity	\$ 94.8

## Statement of Operations

	Three Months Ended June 30, 2018 (In millions)	Nine Months Ended June 30, 2018 (In millions)
Revenues	\$2.8	\$ 14.9
Net earnings of unconsolidated entities (1)	\$2.7	\$ 24.4
D.R. Horton's equity in earnings of unconsolidated entities (1)	\$0.4	\$ 3.1

(1) Earnings in the