AV Homes, Inc.
Form 10-Q
April 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016.

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

For the transition period from ____________ to _____________.

001-07395

Commission File Number

AV HOMES, INC.

(Exact name of registrant as specified in its charter)

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

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

(480) 214-7400

(Registrant's telephone number, including area code)

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

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

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

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

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

As of April 26, 2016, there were 22,648,216 shares of common stock, $1.00 par value, issued and outstanding.

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AV HOMES, INC. AND SUBSIDIARIES

FORM 10-Q

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PART I. Financial Information

ITEM 1. FINANCIAL STATEMENTS

AV HOMES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands)

	March 31, 2016 (unaudited)	December 31, 2015
Assets		
Cash and cash equivalents	$ 15,574	$ 46,898
Restricted cash	1,283	26,948
Land and other inventories	629,780	582,531
Receivables	10,161	7,178
Property and equipment, net	34,496	34,973
Investments in unconsolidated entities	1,187	1,172
Prepaid expenses and other assets	11,241	17,144
Goodwill	19,295	19,295
Total assets	$ 723,017	$ 736,139
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	$ 34,768	$ 33,606
Accrued and other liabilities	30,065	38,826
Customer deposits	12,922	8,629
Estimated development liability	32,512	32,551
Senior notes, net	309,454	320,846
Total liabilities	419,721	434,458
Stockholders' equity		
Common stock, par value $1 per share	22,761	22,444
Additional paid-in capital	400,226	399,719
Accumulated deficit	(116,672)	(117,463)
	306,315	304,700
Treasury stock	(3,019)	(3,019)
Total stockholders’ equity	303,296	301,681
Total liabilities and stockholders' equity	$ 723,017	$ 736,139

See notes to consolidated financial statements.

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Income (Loss)

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
Revenues		
Homebuilding	$ 121,233	$ 53,349
Amenity and other	2,782	2,777
Land sales	75	2,704
Total revenues	124,090	58,830
Expenses		
Homebuilding cost of revenues	98,997	44,589
Amenity and other	2,586	2,383
Land sales	16	285
Total real estate expenses	101,599	47,257
Selling, general and administrative expenses	20,384	13,380
Interest income and other	(24)	(56)
Interest expense	1,272	3,257
Income (loss) before income taxes	859	(5,008)
Income tax expense	68	—
Net income (loss) and comprehensive income (loss)	$ 791	$ (5,008)
Basic income (loss) per share	$ 0.04	$ (0.23)
Diluted income (loss) per share	$ 0.04	$ (0.23)

See notes to consolidated financial statements.

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended March 31, 2016	2015
OPERATING ACTIVITIES		
Net income (loss)	$ 791	$ (5,008)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,566	829
Amortization of share-based compensation	848	885
Impairment charges	161	—
Equity in loss from unconsolidated entities	6	6
Gain from disposal of assets	(11)	—
Changes in operating assets and liabilities:		
Restricted cash	25,665	(4,400)
Land and other inventories	(47,410)	(39,199)
Receivables	(2,983)	(1,005)
Prepaid expenses and other assets	5,473	(23)
Accounts payable, estimated development liability, and accrued and other liabilities	(7,638)	(2,836)
Customer deposits	4,293	4,227
NET CASH USED IN OPERATING ACTIVITIES	(19,239)	(46,524)
INVESTING ACTIVITIES		
Investment in property and equipment	(261)	(249)
Proceeds from sales of property and equipment	11	—
Investment in unconsolidated entities	(21)	(2,109)
NET CASH USED IN INVESTING ACTIVITIES	(271)	(2,358)
FINANCING ACTIVITIES		
Gross proceeds from Senior Secured Credit Facility	35,000	—
Principal payments of notes	(46,793)	—
Other financing activities, net	(21)	(97)
NET CASH USED IN FINANCING ACTIVITIES	(11,814)	(97)
DECREASE IN CASH AND CASH EQUIVALENTS	(31,324)	(48,979)
Cash and cash equivalents at beginning of period	46,898	180,334
Cash and cash equivalents at end of period	$ 15,574	$ 131,355
Noncash transactions:		
Transfer from assets held for sale to land and other inventories and property and equipment	$ —	$ 4,051

Accrued investment in property and equipment	$ —	$ 116

See notes to consolidated financial statements.

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AV HOMES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

March 31, 2016

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of AV Homes, Inc. and all subsidiaries, partnerships and other entities in which AV Homes, Inc. (“AV Homes," “we,” “us,” “our,” or “the Company”) has a controlling interest. Our investments in unconsolidated entities in which we have less than a controlling interest are accounted for using the equity method. The interim consolidated financial statements have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all information and footnotes required by U.S generally accepted accounting principles ("GAAP") for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of AV Homes as of March 31, 2016 and for all periods presented. These statements should be read in conjunction with our consolidated financial statements and notes thereto included in AV Homes' Annual Report on Form 10-K for the year ended December 31, 2015. All significant intercompany accounts and transactions have been eliminated in consolidation.

Beginning with our Form 10-Q for the quarter ended March 31, 2016, the selling, general and administrative expenses related to homebuilding previously included in Homebuilding expenses have been combined with corporate general and administrative expenses and reclassified into a separate new line item called "Selling, general and administrative expenses" to enhance the visibility to our core homebuilding operations and conform with standard industry presentation. The selling, general and administrative expenses reclassified include commissions, other selling expenses and overhead incurred at the divisional level. For the quarter ended March 31, 2015, selling, general and administrative costs of $9.7 million that were previously presented in Homebuilding expenses are now included in Selling, general and administrative expenses. In addition, in accordance with adoption of Accounting Standards Update No. 2015-03, Interest-Imputation of Interest, our debt issuance costs are now presented as a deduction from the corresponding debt liability. This guidance was applied retrospectively and had the effect of reducing our Prepaid expenses and other assets and Senior notes, net balances in our consolidated balance sheets. As of December 31, 2015, unamortized deferred debt issuance costs of $5.9 million were previously presented in Prepaid expenses and other assets on the consolidated balance sheet and are now included as a reduction to Senior notes, net.

Use of Estimates

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

Cash and Cash Equivalents and Restricted Cash

We consider all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. As of March 31, 2016, our cash and cash equivalents were invested primarily in money market accounts that invest primarily in U.S. government securities. Due to the short maturity period of the cash equivalents, the carrying amount of these instruments approximates their fair values.

Our cash items that are restricted as to withdrawal or usage include deposits of $1.3 million and $26.9 million as of March 31, 2016 and December 31, 2015, respectively. The balance as of December 31, 2015 was comprised primarily of $25.6 million on deposit as an interest reserve to comply with the terms of our Senior Secured Credit Facility (defined below). As of February 2016, the Company had achieved compliance with the interest coverage ratio covenant and the restriction on the interest reserve was released.

Land and Other Inventories and Homebuilding Cost of Revenues

Land and other inventories include expenditures for land acquisition, land development, home construction, construction costs for homeowners association amenities, and direct and allocated indirect costs, including interest cost

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capitalized until development and construction are substantially completed. These costs are assigned to components of land and other inventories based on specific identification, relative sales value, or area allocation methods.

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

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

We evaluate our land and other inventories for impairment on a quarterly basis in accordance with ASC 360 to reflect market conditions, including a market by market consideration of supply of new and resale homes for sale, level of foreclosure activity and competition. For assets held and used, if indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset’s carrying value, the carrying value is written down to its estimated fair value. Generally, fair value is determined by discounting the estimated cash flows at a rate commensurate with the inherent risks associated with the asset and related estimated cash flow streams. The discount rate used in the determination of fair value would vary, depending on the state of development. Assumptions and estimates used in the determination of the estimated future cash flows are based on expectations of future operations and economic conditions and certain factors described below. Changes to these assumptions could significantly affect the estimates of future cash flows, which could affect the potential for future impairments. Due to the uncertainties of the estimation process, actual results could differ significantly from such estimates.

During the three months ended March 31, 2016 and 2015, our impairment assessments resulted in $0.2 million and $0.0 million of impairment charges, respectively, and are included in homebuilding cost of revenues in the consolidated statement of operations.

Receivables

Receivables primarily consist of amounts in transit or due from title companies for house closings and mortgage notes receivable from the sale of land.

Property and Equipment, net

Property and equipment, net are stated at cost and depreciation is computed by the straight-line method over the following estimated useful lives of the assets: land improvements 10 to 25 years; buildings and improvements 8 to 39 years; and machinery, equipment and fixtures 3 to 7 years. Maintenance and operating expenses of equipment utilized in the development of land are capitalized to land inventory. Repairs and maintenance are expensed as incurred.

Property and equipment, net includes certain amenities such as club facilities on properties owned by us. These amenities include expenditures for land acquisition, land development, construction, and direct and allocated costs, including interest cost incurred during development and construction.

Each reporting period, we review our property and equipment for indicators of impairment in accordance with ASC 360. For our amenities, which are located within our housing communities, indicators of potential impairment are similar to those of our housing communities (described above), as these factors may impact our ability to generate revenues at our amenities or cause construction costs to increase. In addition, we factor in the collectability and potential delinquency of the membership dues for our amenities. For the three months ended March 31, 2016 and 2015, we did not identify indicators of impairment for property and equipment.

Assets Held for Sale

We classify assets held for sale in accordance with the criteria set forth in ASC 360. We continue to opportunistically sell non-core commercial and industrial assets, as well as scattered lot positions and land assets that are

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in excess of our needed supply in a given market. Under this plan, assets that meet the criteria above are classified as held for sale.

During the three months ended March 31, 2015, we changed our plans to sell assets that were previously classified as held for sale, or the assets no longer met the held-for-sale criteria, resulting in a reclassification of $4.1 million of land positions to land and other inventories. There was no change in the carrying value in these assets due to this reclassification.

Investments in Partnerships and LLCs

When we are either deemed to hold the controlling interest in a voting interest entity or deemed to be the primary beneficiary of a variable interest entity (“VIE”), we are required to consolidate the investment. The primary beneficiary of a VIE is the entity that has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb the majority of losses of the VIE or the right to receive the majority of benefits from the VIE. Investments where we don't hold the controlling interest and we are not the primary beneficiary are accounted for under the equity method.

Factors considered when determining if we hold the controlling interest in a voting interest entity include who holds the general partnership or managing member interests, which partner or member makes the day-to-day decisions regarding the operations of the entity, and whether or not the other partners or members have substantive participating rights. With respect to VIEs, our variable interests may be in the form of (1) equity ownership, (2) contracts to purchase assets and/or (3) loans provided by us to the investor. We examine specific criteria and use judgment when determining if we are the primary beneficiary of a VIE. Factors considered in determining whether we are the primary beneficiary include risk and reward sharing, experience and financial condition of other partner(s), sufficiency of equity to conduct the operations of the entity, voting rights, involvement in decisions significantly impacting the entity's economic performance, level of economic disproportionality between us and the other partner(s) and contracts to purchase assets from VIEs.

We have investments in unconsolidated entities, including joint ventures, with independent third parties. The equity method of accounting is used for unconsolidated entities over which we have significant influence. Under the equity method of accounting, we recognize our proportionate share of the earnings and losses of these entities.

We evaluate our investments in unconsolidated entities for recoverability in accordance with ASC 323, Investments - Equity Method and Joint Ventures (“ASC 323”). If we determine that a loss in the value of the investment is other than temporary, we write down the investment to its estimated fair value. Any such losses are recorded to equity in (earnings) loss of unconsolidated entities in the consolidated statements of operations and comprehensive income (loss). Due to uncertainties in the estimation process and the significant volatility in demand for new housing, actual results could differ significantly from such estimates. During the three months ended March 31, 2016 and 2015, we did not identify indicators of impairment for our investments in unconsolidated entities.

Business Acquisitions

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

Goodwill

Goodwill arises from business combinations and represents the excess of the cost of an acquired entity over the net fair value amounts that were assigned to the identifiable assets acquired and the liabilities assumed. Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. There were no indicators of impairment during the three months ended March 31, 2016 and 2015.

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Homebuilding Revenue Recognition

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

Sales Incentives

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

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs, sales commissions and closing costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations and comprehensive income (loss).

Warranty Costs

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

During the three months ended March 31, 2016 and 2015, changes in the warranty reserve consisted of the following (in thousands):

	Three Months	
	2016	2015
Accrued warranty reserve, beginning of period	$ 3,333	$ 1,528
Reserve provided	126	693
Payments	(532)	(710)
Accrued warranty reserve, end of period	$ 2,927	$ 1,511

Income Taxes

Income taxes have been provided for using the asset and liability method under ASC 740, Income Taxes ("ASC 740"). The asset and liability method is used in accounting for income taxes where deferred tax assets and liabilities are recognized by identifying the temporary differences arising from the different treatment of items for tax and accounting purposes. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is primarily dependent upon the generation of future taxable income. In determining the future tax consequences of events that have been recognized in the financial statements or tax returns, judgment is required. Differences between the anticipated and actual outcomes of these future tax consequences could have a material impact on our consolidated results of operations or financial position.

We evaluate our deferred tax assets quarterly to determine if valuation allowances are required. ASC 740 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a "more likely than not" standard. The realization of the deferred tax assets ultimately depends upon the existence of sufficient taxable income in future periods. We established a valuation allowance against our

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deferred tax assets in 2009 and regularly analyze all available positive and negative evidence in determining the continuing need for a valuation allowance with respect to our deferred tax assets. This evaluation considers, among other factors, historical operating results, our three-year cumulative profit or loss position, forecasts of future profitability, and the duration of statutory carryforward periods. We earned a profit before income taxes for the year ended December 31, 2015, and pre-tax income for the first quarter of 2016 was slightly positive. Additionally, we have seen significant increases in community count, new orders, and backlog. If homebuilding industry conditions and our business remain stable and additional positive evidence develops, we believe there could be sufficient positive evidence to support a conclusion that we will generate sufficient taxable income in future periods to realize all or some portion of our deferred tax asset, which would allow us to significantly reduce the valuation allowance at some point during 2016.

During the three months ended March 31, 2016, we recognized a decrease of $0.6 million in the valuation allowance. As of March 31, 2016, our deferred tax asset valuation allowance was $123.9 million.

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

Share-Based Compensation

On June 3, 2015, shareholders approved and we adopted the 2015 Incentive Compensation Plan (the "2015 Plan"), which replaced the Amended and Restated 1997 Incentive and Capital Accumulation Plan (2011 Restatement), as amended (the “Incentive Plan"). Each of the Incentive Plan and 2015 Plan provide for the grant of stock options, stock appreciation rights, stock awards, performance awards, and stock units to officers, employees and directors of AV Homes. The exercise prices of stock options granted under the Incentive Plan or the 2015 Plan may not be less than the stock exchange closing price of our common stock on the date of grant. Stock option awards under the Incentive Plan and 2015 Plan generally expire 10 years after the date of grant.

As of March 31, 2016, an aggregate of 590,483 shares of our common stock, subject to certain adjustments, were reserved for issuance under the Incentive Plan, relating to outstanding options and restricted stock units previously awarded prior to the adoption of the 2015 Plan and currently outstanding under the Incentive Plan. There were approximately 442,264 shares available for grant as of March 31, 2016 under the 2015 Plan and 24,698 shares reserved for issuance relating to restricted stock units previously awarded and currently outstanding under the 2015 Plan.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to AV Homes stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of AV Homes. The computation of diluted earnings (loss) per share for the three months ended March 31, 2016 did not assume the effect of employee stock options or the 6.00% Notes because the effects were antidilutive. The computation of diluted earnings (loss) per share for the three months ended March 31, 2015 did not assume the effect of outstanding restricted stock, restricted stock units, employee stock options, the 7.50% Senior Convertible Notes or the 7.50% Senior Convertible Exchange Notes because the effects were antidilutive.

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The following table represents a reconciliation of the net income (loss) and weighted average shares outstanding for the calculation of basic and diluted earnings (loss) per share for the three months ended March 31, 2016 and 2015 (in thousands, except share and per share data):

	Three Months	
	2016	2015
Numerator:		
Basic and diluted net income (loss)	$ 791	$ (5,008)