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Meritage Homes Corp. (MTH)

Q3 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Meritage Homes Third Quarter Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Brent Anderson, Vice President of Investor Relations. Please, go ahead.

Brent A. Anderson

Vice President-Investor & Media Relations, Meritage Homes Corp.

Thank you, Amy. Good morning, everyone. I'd like to welcome you to our analyst conference call today. Our third quarter 2013 ended on September 30. We issued our press release with the results before the market opened today. If you need a copy of the release or the slides that accompany our webcast, you can find them on our website at investors.meritagehomes.com or by selecting the Investor Relations' link at the bottom left of our homepage.

Turn to slide two in the presentation, our statements during this call and the accompanying materials contain projections and forward-looking statements which are the current opinions of management and subject to change. We undertake no obligation to update these projections or opinions.

Additionally, our actual results may be materially different than our expectations due to various risk factors. For information regarding these risk factors, please see our press release and most recent filings with the Securities and Exchange Commission, specifically our 2012 Annual Report on Form 10-K and our second quarter 2013 report on Form 10-Q.

Today's presentation also includes certain non-GAAP financial measures as defined by the SEC. So to comply with SEC rules, we've provided a reconciliation of those non-GAAP measures in our earnings press release.

With me today to discuss our results are Steve Hilton, Chairman and CEO of Meritage Homes; and Larry Seay, our Executive VP and CFO. We expect our call to run about an hour and a replay of the call will be available on our website within an hour or so after we conclude the call, and it will remain active for 15 days.

I'll now turn it over to Mr. Hilton to review our third quarter results. Steve?

Steven J. Hilton

Chairman & Chief Executive Officer, Meritage Homes Corp.

Thank you, Brent. Good morning, everybody. We're pleased with our strong operating results for the third quarter of 2013. We achieved significant growth in closings, revenue, margins, and earnings again this quarter. And we grew orders year-over-year despite headwinds from the significant increases in home prices and interest rates as well as the recent turmoil caused by Washington.

We believe the market tossed a long runway ahead for additional growth. This somewhat slower sales pace we're experiencing is actually healthy and it allows the market to return to more sustainable pace. Market fundamentals remain strong. So we are not overly concerned about the slowing in the pace of sales, though we do not expect to return to the same frothy sales pace we saw earlier in the year. We are confident that we can continue to grow our earnings through both top line growth and operating leverage. I'll address our order trends and what's behind those in a few minutes. But we'll begin with the review of our operating results.

We're now on slide four. We are at $0.99 per diluted share for the third quarter this year, more than five times as much as last year's $0.19 per diluted share for the third quarter. Net earnings were up 463% year-over-year. Home closing revenue increased 44% with an 18% increase in home closings and a 22% increase in average closing prices. This was our eighth consecutive quarter of year-over-year growth in home closing revenues and our seventh consecutive quarter of year-over-year earnings growth. Since we entered the quarter with a backlog value of 65% or higher than a year ago, we expect to see substantial year-over-year growth in home closings again next quarter.

Slide five. Because home price increases have exceeded the increases in our land and construction costs, our home closing gross margin increased by 420 basis points to 22.8% compared to 18.6% in the third quarter of last year. This may go marginally higher for a couple more quarters. We expect gross margins to return to a more normalized level as demand and prices begin to stabilize. The margin expansion highlights the fact that we shift our focus from volume growth to maximize the profitability of our assets over the last several quarters and our earnings have grown accordingly.

You can see that reflected in year-over-year price – I'm sorry, you can see that reflected in our year-over-year price and volume comparisons by quarter. While our increases in average prices are partially due to our mix shifting towards higher priced communities and states, the price increases we took in many communities generated much of the 22.8% home closing gross margin in the third quarter of this year, a 130 basis point improvement over the second quarter.

Our operating leverage also contributed to our earnings growth. Our total SG&A expenses dropped 140 basis points year-over-year and interest expense dropped another 80 basis points from last year's third quarter. Larry will go through more of these details in a bit.

Slide six, this was our 10th consecutive quarter of positive year-over-year growth in orders, though the 8% growth was less than previous quarters for several reasons. Year-over-year order comparisons are more difficult considering that orders were up 33% last year over 2011's third quarter, but there is more to it than that. Low prices and low interest rates coupled with low inventories and homes available drove much of our sales growth last year and earlier this year. Since we are selling out of communities batch and then we can replace them, we raised prices repeatedly in the areas where demand was the strongest until we reached a point where sales per community came down to a more normalized pace. Late in the second quarter, the sudden and steep rise in the interest rate came just as the spring selling season was ending and we were entering the seasonally slow summer months, causing buyers to pause in their purchasing decisions.

We believe the rapid price increases had more impact on buyers than interest rates. And it may take some time for buyers to adjust their expectations to current price levels. For Meritage, our average sales price on orders were up 20% in the third quarter of 2013 over 2012, which produced a 29% growth in total older value, despite an only 8%, increase in unit orders.

We also added 14 net new communities during the quarter, including three net new communities from Nashville as we opened 27 net new communities and closed out 13 net new communities. Our average active community count in the quarter was 13% higher than 2013, than it was in 2012. Yet our average orders per community were only slightly lower this year than last year.

We sold an average of 7.6 homes per community in the third quarter of this year compared to 7.9 per community in the third quarter of last year. Since the fourth quarter is normally our slowest selling quarter seasonally, we wouldn't expect to see sales pick up until the spring selling season next year. However, we are planning to increase our active community count and are comfortable with our previous projection of a 185 communities by end of the year 2013 and we plan to grow this by another 10% to 20% next year.

Slide seven. We grew our total order value and backlog value across the board except in California where orders and order value declined after we raised prices more significantly there. California had the highest average orders per community since early 2012. It was 12.7% in the third quarter of 2012, and 17.9% in the second quarter this year. We have been selling out communities in California faster than we can replace them. So our average community count was down 21% year-over-year and orders were down 33%.

I'll note that we did increase our community count in California by 5% from the second quarter to third quarter as our recent land acquisitions are starting to come online. Our total order value in California was only down 11% due to a 34% increase in our average sales price. After running an unusually high sales pace for several quarters, we're getting back to a more reasonable sales pace there as it was at 10.6% this past quarter.

California is achieving the highest returns in the company. As evident in our result, the strategy of focusing more on price than volume has been working. We are earning much more per home. So, our gross profit has increased much faster than our home closings have. The strategy results are similar in Colorado, which had the second highest orders per community across the company in four quarters of the last five quarters.

Our average sales price in Colorado was 40% higher year-over-year in the third quarter. We took orders from 8 homes per community there in the third quarter – to 8 homes per community there in the third quarter, roughly in line with the company average. We also had a 50% more active communities in Colorado in the third quarter of 2013 than 2012. Orders were up 9% year-over-year, and our ASP increased 40%, driving a 52% increase in total order value.

Arizona's average community count was up 14%, offsetting a 10% decline in orders per community. So our net orders there increased 2%. Average sales prices were up 12% and our total order value in Arizona increased 15%. Demand remained strong in Phoenix even after pushing prices aggressively there over the last year and it is one of our most profitable markets. Our sales pace is lower in Tucson in the active adult markets which brings the average for Arizona down, though all of our Arizona markets are still producing very good margins.

Turning to slide eight. We were pleased with the growth we achieved in Texas during the third quarter where we grew orders by 28% year-over-year, primarily by increasing our average orders per community by 21% over the third quarter of 2012. Sales per community in Texas had lagged the rest of the company over the past several quarters, but were right in line with our company average this quarter. With a 16% increase in ASP on top of that order growth, we generated a 49% increase in total order value for the quarter in Texas.

Slide nine. We are growing our East region through expansion to the new markets in the Carolinas and Tennessee where we recently completed the acquisition of Phillips Builders, a long established builder with high quality reputation in the Nashville area. Florida is still growing strong. We've expanded our Carolinas operations significantly over the last year and ended the quarter with 15 communities there compared to seven communities last year. Since many of those communities were newly opened and not in full stride yet, our pace of sales were down 15% in the Carolinas. Yet, we doubled our orders and total order values were up 128% from a year ago. Florida has quite a few new communities with deep lot positions that are remaining open longer. So new community opens there are increasing our store count. We ended the quarter with 27% more active communities in Florida than a year ago, which drove a 13% increase in orders. Florida's average prices were up 33% and total order value for the quarter increased 51% over last year's third quarter.

With that, I'll turn it over to Larry to review a few other highlights of the third quarter. Larry?

Larry Wayne Seay

Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

Thanks, Steve. Turning to slide 10. In addition to the 500 lots that Steve noted from the Phillips Builders' acquisition, we added approximately 3,700 new lots during the third quarter, which was the second highest number of lots we've secured in the last two years after the fourth quarter of 2012. We secured some great positions in highly desirable locations in our key markets including those in the areas where demand has been the highest like California, Colorado and Arizona while solidifying our positions in the Carolinas and aiming communities in some of the best submarkets in Houston and Dallas-Ft. Worth, which are strengthening markets. We ended the quarter with approximately 25,000 total lots under control, 40% more than a year ago, and about 2,400 lots more than where we finished the second quarter of this year. We now have the equivalent of approximately five years supply of lots based on our trailing 12 months closings. We invested approximately $167 million in land and land development during the third quarter of 2013 to continue to grow the business and have a healthy pipeline of potential new positions with all of our 2014, and more than 85% of our 2015 closings owned or under contract.

Slide 11. Total closing profit increased $51 million or 81% over the third quarter last year, including approximately $3 million of land closing gross profit from the sale of excess lots in certain areas, in addition to the $48 million increase in home closing gross profit. We also increased financial services profit by a little over $1 million primarily from increased closing volume. Commissions and other sales costs came down to 6.9% of home closing revenue, an 80 basis point improvement over the third quarter of 2012.

G&A expenses were down 60 basis points year-over-year to 5.0% of total closing revenue and interest expense was down $1.5 million or 80 basis points year-over-year. With that leverage, we generated an 11.5% pre-tax margin for the third quarter of 2013 compared to 2.0% for the third quarter of 2012. It was also a 300 basis point increase over the second quarter of this year.

Our 2012 results included an $8.7 million charge to increase reserves surrounding litigation in the South Edge joint venture in Las Vegas. Our tax provision was $18.6 million in the third quarter of 2013 compared to just $202,000 for the third quarter of 2012. That's an effective tax rate of about 33% for the third quarter of 2013, which is less than the statutory rate, partially due to energy tax credits we receive. We project that our effective tax rate for the full year will end about 31% to 32% range.

Moving to slide 12. Looking at our results year-to-date, we generated $78 million net earnings in the first nine months of 2013, compared to $10 million in the first nine months of 2012, a seven-fold increase. For the first nine months of the year, home closing revenue was up 52% year-over-year with a 26% increase in home closing and a 20% increase in average closing prices. Home closing gross margin, up 21.5% was 330 basis points higher than last year due to home price appreciation, better direct cost control and construction overhead leverage. Commissions and other sales costs were down 110 basis points.

General and administrative expenses were down 90 basis points as we are leveraging our existing overhead platform over greater revenues, and interest expense was down 130 basis points year-over-year, as we are capitalizing a greater portion of our interest incurred to additional inventory under development.

Our pre-tax margin for the first nine months of 2013 improved 810 basis points to 8.7% compared to 0.6% in 2012. Orders were up 21% year-over-year for the first three quarters of the year and average sales prices were up 22%, yielding a 48% increase in total order value over the first nine months of 2012.

Slide 13. Our balance sheet is strong and we believe we have adequate capital and financing capacity to support additional growth. We ended the quarter with $311 million of cash and cash equivalents, restricted cash and securities, $16 million higher than our December 31, 2012 balance.

Our net debt-to-capital ratio at September 30, 2013 was 13.1% – excuse me 38.1%, consistent with our year end ratio. We also have $135 million revolving credit facility and have borrowed nothing against that line to date. Our total real estate inventory rose to $1.4 billion at September 30, 2013 from $1.1 billion at the beginning of the year. More than half of that increase was from additional homes in construction under contract, while most of the remaining increase was due to increased land under development. We had total of 652 spec homes started but not yet sold at quarter end, of which 442 spec homes were under construction compared to 643 spec homes at December 31, 2012.

With that, I'll turn it back over to Steve before we begin Q&A.

Steven J. Hilton

Chairman & Chief Executive Officer, Meritage Homes Corp.

Thank you, Larry. We were pleased with our results for the third quarter, particularly our bottom line earnings growth, which demonstrates the success of our strategies. We've grown our top line by expanding into new markets, growing our community count and maximizing prices at a reasonable sales pace. We've managed to keep cost increases lower than the increase in our sales revenue which generated a 420 basis point improvement in our home closing gross margin. And we are driving greater earnings growth from every dollar increase in our gross profit through operating leverage. We expect to continue to grow our earnings with these strategies going forward and we've managed a strong balance sheet while improving our credit metrics as we've grown and expanded our footprint.

Most housing metrics have been moving in a positive direction over the last year albeit from a historically depressed levels. As the U.S. economy slowly improves and creates jobs, demand for new homes should remain strong especially in light of the shortage of used homes listed for sale. We believe the Meritage is well positioned with highly desirable locations and distinctive energy efficient homes in many of the best housing markets in the country. Based upon our reported results year-to-date and assuming continued strength in our markets, we are projecting home closing revenue of approximately $1.8 billion for 2013 with projected earnings per diluted share in the range of $2.95 to $3.05 for the year.

I thank you for your attention and we'll now open up for questions. The operator will remind you of the instructions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Michael Rehaut of JPMorgan.

Michael J. Rehaut
Analyst, JPMorgan Securities Inc.
Q

Thanks. Good morning and congrats on the quarter. First question I had was on order trends. If it's possible to give us any granularity in terms of how they progressed throughout the quarter and in particular I'm interested in the company-wide sales pace per community. I would assume that perhaps the – with it down 5% on average throughout for the quarter overall, just trying to get a sense if it was perhaps worse at the beginning of the quarter and perhaps better than that average number at the end then just to give us a sense because we've heard that it in our own fieldwork that September was a little bit better than August, and just trying to get a sense if that's what you saw.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

For us, it was a negligible difference month-to-month. August was actually our best month of the three-month period, but the differences were so slight it's really hard to put much into it. We are talking less than 5% difference month-to-month, so I wouldn't read into that. It varied by region. In Texas, July and September were like bookings and August was a little weaker. It is a little weaker in the West in September, but it was a little stronger in the Southeast in September, so it was pretty flat throughout the entire quarter.

Michael J. Rehaut
Analyst, JPMorgan Securities Inc.
Q

Okay. And in terms of the commentary around gross margins, you expect them to increase modestly I guess in the fourth quarter before beginning to normalize. How should we think about that path to normalization and what would you think is more of a normal level? I mean, in the late 1990s, early part of last decade, you're more or less right around 20%, plus or minus pretty consistently. Would we expect to get back to that 20% mark perhaps on a graduated pace through the end of 2014 or would it be even more gradual than that, given some of the land in your books that you already have locked up?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

I think we're going to have margins at or above where we are right now for the next two quarters or three quarters and then I think we will start to gradually go down probably more towards 21% than 20%, but it's hard for me to pinpoint the exact rate of that dissent, but I'll tell you more as we get into next year.

As our margins decline in California, they're pretty amazing right now. Our margins are improving in other markets like Texas. [indiscernible] (22:47) mitigate over themselves.

Michael J. Rehaut
Analyst, JPMorgan Securities Inc.
Q

No, thanks. I just want to make sure to understand this. It's part of the confidence there that you're still going to have pretty solid margins for two quarters to three quarters and more of a gradual decline following that. Is that due to perhaps the pricing and incentives remaining relatively firm throughout, the third quarter with the slower pace of demand and maybe in general, if you could just talk about pricing and incentive trends over the last three months or four months?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

We haven't really increased our incentives that much. We've done it on a select basis over this last quarter between 1% and 2% where we think we needed it and I don't think we are going to be doing much more this quarter. So, the gross margin picture, we'll have to look at that more as we go into the next year and as we see how the spring selling season plays out, but I think a bigger impact on the margins is really going to be land cost. And as we move into more expensive land, that will have the biggest impact. So...

Michael J. Rehaut
Analyst, JPMorgan Securities Inc.

Q

Thank you.

Operator: Our next question comes from Stephen Kim at Barclays.

Stephen S. Kim
Analyst, Barclays Capital, Inc.

Q

Thanks guys. First, great job in the quarter, really, really impressive and yes, I'm glad to hear you talk, Steve, about the fact that higher land costs are going to be coming through and making sure expectations are set probably on the margin trajectory going forward. I think most of your peers are going to wind up seeing the same thing. But, I guess I wanted to ask you about your land spend strategy. One of the things I've been interested in is to observe that relative to the size of your business, your amount of land sales this year has been on the lower end of your peer group when you adjust for the fact that you guys in general don't have a particularly long land bank. So you kind of have been fairly moderate in your land purchases this year relative to peers. And I was curious as to whether or not you could comment on what you're seeing in the land market now and why you have generally felt it wasn't the right strategy to be very aggressive in buying land over the last few quarters like some of your peers have?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

I think we were aggressive this last quarter, we bought 3,700 lots.

Stephen S. Kim
Analyst, Barclays Capital, Inc.

Q

That was about 35%. You spent about 35% of revenues which is pretty typical for builders going back over the last 20 years on average. Some of your peers are well up into the 40%s or in some cases even above that, so as a percentage of the amount of land you're burning through, your replenishment rate was fairly normal.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

I don't know if I – I mean you're talking about what we're actually spending in cash or we're actually committed to spend?

Stephen S. Kim
Analyst, Barclays Capital, Inc.
Q

Your cash spend.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Yes, well that's not really that important, what's really important is what we put under contract, and what we've committed to spend, or we have under control. And that's that 3,700 lots that I'm talking about. That was a super strong quarter for land purchases for us that we approved in and we'll be purchasing over the next several quarters as these lots come online. So I don't have the number in front of me. Larry might have it, but year-to-date, I believe we've purchased over 8,000 lots. And so we've been fairly aggressive relative to our run rate on lot acquisitions.

Stephen S. Kim
Analyst, Barclays Capital, Inc.
Q

Okay, so basically you believe that the time is right now to be tying up a lot of land. So although you've not been spending a lot in the way of cash, you've been tying up a lot of land in the way of options and things like that. Is that what you're referring to?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Well, again I'd say it's a market-by-market situation. Certain markets like Phoenix, we've got a really big land book here. We've got a lot of great locations. We don't need a lot of land. We bought land early here and always like to have more land in California, but it's hard to get. We've really bought some phenomenal positions in Houston. We're really excited about our business down there. Other markets like Dallas, we would like to buy more land, but it's been hard to find land that works. So in some places, I'm pulling back on the gas pedal, lifting the foot off the gas pedal. In other places, I'm putting the foot down harder. So, it's a market-by-market strategy.

Stephen S. Kim
Analyst, Barclays Capital, Inc.
Q

Okay.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

Steve, if I could add a couple of things here. We've put under control about 8,600 lots for the first three quarters this year but we also are auctioning more land bankings coming back. We've closed eight deals over the last couple of quarters for a total purchase price of lots of about $126 million. And we have now a little under 30% of our total lots under control, controlled through purchase contracts or options. So, that number is starting to come up and that is part of our long term strategy of controlling some of our land off balance sheet through non-recourse option, so you're seeing us start to re-implement the strategy we used last cycle.

Stephen S. Kim
Analyst, Barclays Capital, Inc.
Q

Yes, and that worked well for you. What was your finished lot count?

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Finished lot count, I don't have that off the top of my head. We have more lots under development today than we have, I think our finished lot counts are roughly in the pan of 30% to 40% range, I don't have the specific number, but because we've been buying almost all raw land, a lot of our lots are under development in some way or another, and we're spending more in land development because of that.

Stephen S. Kim
Analyst, Barclays Capital, Inc.

Q

Got it. Thanks guys.

Operator: Our next question comes from Ivy Zelman at Zelman & Associates.

Ivy L. Zelman
Analyst, Zelman & Associates

Q

Thank you, and good morning. Congratulations on the quarter, guys. Steve, you talked about margins over the next few quarters showing approximately the current level you're running at. What are your assumptions in expecting the margins to decelerate in terms of expectations on home prices? Are you assuming the prices are going to be flat so that obviously the lower cost or high cost land is not being offset with home price inflation?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Well, I think margins are going to vary. Our prices are going to vary by market and I expect prices in California to continue to rise, maybe more in the 5% to 7% range. And maybe Arizona and Colorado be more in the 3% to 5% range and then other markets closer to that number. But as I said earlier, I think the biggest impact for us, our margins going forward, is going to be land cost. Particularly in California, it's going to be difficult for us to replace some of that land that we got at really good prices. That said, we had five communities we opened this quarter in California and we have more coming at still at pretty good prices. So, I don't expect our margins are going to drop off the cliff, I think, they're going to gradually decline over the next year to two years.

Ivy L. Zelman
Analyst, Zelman & Associates

Q

And that price assumptions that you're underwriting to a 5% to 7% increase from the new land that you're buying for a price inflation account for now?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Yes, we only underwrite with appreciation in select few communities in California and in most cases, it is even less than that.

Ivy L. Zelman
Analyst, Zelman & Associates

Q

So, then really your expectation is to not get inflation into offset the higher cost of land and yet you are thinking that margins would be weaker as a result of that. So, I guess, I'm a little confused. So, if you're not underwriting [indiscernible] (31:01).

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

We don't underwrite – I'm sorry, we don't underwrite to the margins we are achieving today. We underwrite to more of a normal margin. Our margins in California right now that we're achieving are way above what we underwrite to. So, just for the fact that we're going to have lower margins, just by the fact that we're cycling new land through that we're not going to get depreciation though we had last year.

Ivy L. Zelman
Analyst, Zelman & Associates
Q

Got it. And then secondly, just, I'm sorry. Go ahead, Larry.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

I was going to say, Ivy, the other thing is, we typically don't underwrite any inflation on the revenue or cost side and only in rare instances do we underwrite some revenue appreciations. So, our strategy is to not expect appreciation that is more than cost. So if we get some, it's all gravy to us.

Ivy L. Zelman
Analyst, Zelman & Associates
Q

Got it. No, that makes sense. And with other new communities that you've been opening, maybe you can talk about some of the impediments that had been prevalent with respect to constraints on whether it'd be local municipalities and utilities getting to job sites or just the labor component and you sound like you're on track to deliver where you expected. So, are those impediments for the most part starting to alleviate? And then when you open the new communities and we think about sales pace slower, are your new communities opening at the price points you expected or have you had to lower list price and how has been the overall reception to the new communities. Is there a better performance on sales paced in those communities and are you at the original list price that you had expected to be opening them at?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Okay. So, I will take kind of in reverse order. I would say that almost all of our communities we've opened over the last quarter or two quarters have opened at the prices that we perform at or higher, in most cases higher, of course, because we underwrite these communities at least a year ago, if not more. I would say that we don't have the lineup of people to buy early in these communities that we had a few quarters ago, particularly in the West, but almost all of them have opened to a good sales pace. I would say our biggest problem right now in bringing communities online is not so much on the construction side with trades, buying trades to complete the work. I think we've kind of got that under control. The biggest challenge we face is really more in the municipalities. And the delays we are encountering getting communities through the entitlement and plan approval and our permitting process and it's backing up in some locations which is delaying us against some of our projections, our community openings but we're managing through it .

Ivy L. Zelman
Analyst, Zelman & Associates
Q

And that's why you might have that wide range of 10% to 20% because you want to be conservative, given those delays?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Yes.

Ivy L. Zelman
Analyst, Zelman & Associates
Q

Okay. Thanks, guys.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Thank you.

Operator: Our next question comes from Nishu Sood, Deutsche Bank.

Nishu Sood
Analyst, Deutsche Bank Securities, Inc.
Q

Thanks. I wanted to follow-up on the community count question. So the 185 communities by year end, you're still comfortable with that. Now, I know you haven't given specific numbers for 2014 or 2015, but you did mention that you have most of the land under control for your deliveries in 2014 and 2015. So, I was just wondering if you could talk directionally after this terrific year of community comp growth you have, which has been very well timed, what we might be looking at directionally for 2014 and 2015?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Yes. I'm not prepared yet to give guidance on 2014 as far as revenues and orders and all that. I mean, I'll try to do it next quarter. But, I don't really want to say anything more other than community count is going to grow up between 10% and 20%.

Nishu Sood
Analyst, Deutsche Bank Securities, Inc.
Q

Got it. Okay. And also wanted to ask about your land spend, the quarterly profile of it. If you look at the last few years, it's followed a seasonal trend where it's lowest in the first quarter and then it rises through the rest of the year. Now you guys have done a great job of managing the balance sheet. So, I was just wondering what's been driving that seasonal profile. Is it for example to do with development spend ahead of the spring selling season and how should we expect that to look going forward?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Well, I think a lot of sellers want to get deals closed by year end. So, you're pushing a lot of lots through the pipeline to get them closed by December and then we have a slowing of activity in Q1, it starts to build up again through the year.

I wouldn't put a lot of weight into that though. I don't know that we'll have as big a land spend in Q4 this year than we had in our land – maybe not land spend, land commitment in Q4, as we had in Q3. The spend will certainly probably go up, because we have a lot of deals closing, but the commitments may not increase, or probably, will actually decrease.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

Yes, that's not a metric we manage the business too and if there're some seasonal pattern that has developed, it's not something that we are purposely managing and I don't think it's that significant in running the business properly.

Nishu Sood
Analyst, Deutsche Bank Securities, Inc.
Q

Got it. And just housekeeping wise on the Phillips' acquisition. How much of that add to backlog and orders in 3Q?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Larry?

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

The backlogs was around 40 units or 45 units and it's that, it's a small business doing 100 units, 150 units that we plan to grow rapidly. It really provides us with a good platform and good connections in Nashville in which to deploy our excess cash.

Nishu Sood
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. Great. Thanks.

Operator: Our next question comes from Stephen East at ISI Group.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.
Q

Oh, thank you. Congratulations on the quarter guys.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Thanks.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.
Q

Steve, I don't know maybe this is for Larry, but if you look at the incentives, you've said they haven't gone up much. I guess what I am interested in is what type of incentives are you seeing consumers gravitate to and are you seeing differences geographically in the amount of incentives you have to use and also between different buyer profiles, first move up, second move up, and I know you do just a little bit of entry level, but if you can just give us some more color around all of that issue.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Well, I can tell you what they are not buying on is interest rate related incentives like buy downs. We've kind of experimented with those and they haven't really made much of a difference. So we kind of stopped trying to put those out there. I mean the typical incentives are pretty much what we've always been using which is towards options, money to use towards upgrades and options, and we've changed that around a little bit, sort of a little bit of a, little secret sauce formula, but it's all option related and I would say there is not much difference between first move up and second move up. It's pretty much the same. Certainly, we are using less incentives in California than we are probably in other places, but there is not a very wide difference by geography.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.

Q

Okay. That's helpful. So by not having buy downs and is that telling you then that you think the consumer is fine on affordability and that type of thing and maybe just a bit more of sticker shock that they have to work through.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Yes, it says 70% to 80% sticker shock and headline shock, and I think this Washington thing is really having an impact on the most recent sales. And I don't think it's interest rates.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.

Q

Okay, all right. Thanks. You all have talked a lot about the gross margin, I guess, while that's important, I guess, I'm a bit more focused on what your ultimately your operating margin would be as you move forward in time. So, I'm wondering a few things there. What type of leverage do you think you have on your SG&A? You all have moved that lower at – as a percentage of sales faster than I thought you would? And where do you think SG&A goes up, margin goes, and then also embedded right now what do you think your true ASP in price increase is versus mix in the quarter that just ended?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

I'm going to pump that over to Larry. Larry?

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Well, to answer the first question, we are hopeful that in growing the top line even though over the next few quarters, margins may start to contract a little bit that we're going to top line can continue to leverage our overhead and we can continue to bring down commissions and other selling costs and about half of that number is more fixed selling cost than commission. So there is ability to leverage that and then we should be able to leverage it with the G&A, number two. I'm not prepared to tell you how much on a percentage basis, but we're hopeful that that will help maintain the bottom line pre-tax margin even though gross margins might erode a bit. What was the second question?

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.

Q

If you look at your ASPs, how much they've gone up? How much of that is true pricing versus mix?

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Yes, the last couple of quarters, the actual true price increase has been 2/3 to 3/4 of the change and it hasn't been as much mix related as it was a year or so ago.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.

Q

Okay. All right. That's helpful. And then just one last question along those lines, you've talked about your land cost. What's going on the construction side? I'm thinking about everybody has talked about labor. Is labor changing any and are you seeing any of the materials start to move meaningfully one direction or another?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

It's not having the impact that we saw a couple few quarters ago. We got it under control. It's not to say it's still not an issue that we're managing every day. We have challenges in different areas whether it's brick masons or framers or whatever maybe, but we have to manage to it, and it's a market-by-market situation. So, I'm not going to put that out there as an excuse today for future results, but it's under control for now.

Stephen F. East
Analyst, International Strategy & Investment Group, Inc.

Q

Okay. Thanks a lot guys.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Thanks.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Thank you.

Operator: Our next question comes from David Goldberg at UBS.

David I. Goldberg
Analyst, UBS Securities LLC

Q

Thanks. Good morning, everybody.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Good morning.

David I. Goldberg
Analyst, UBS Securities LLC

Q

I wanted to follow-up on the earlier question. I think it was Steve's question on land banking, and I wanted to talk about how you guys are seeing the market for land banking evolve as we move through the downturn? And is it through the upturn here and now there is a little bit of a pause? Are you seeing the availability of dollars for land banking in off balance sheet range change significantly and do you think that's an opportunity to change the trajectory of your growth as you move forward and I think, you've talked in the past, you don't think it's going to be where it was certainly in 2004 and 2005, but how much are we losing in terms of the availability of credit there?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Well, a year ago it was like zero. So anything above zero is good. There's a few big players that have entered the space and are doing quite a few deals. I don't know how deep those pockets are and how long they're going to be in it, but while it's available to us we're going to aggressively pursue it. I don't think it's going to return anywhere near to where it was in the previous cycle, because there just isn't the capacity there that we saw before. But I still think it's something that makes a lot of sense and will really help drive our growth.

< A – [05GM1T-E Larry Seay]>: And just together....

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Oh, sorry, Larry, go ahead.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

[indiscernible] (44:23) there's probably about 10 people we're talking to that we've either done business with or are talking about doing business with. So, and it's not like there's tens or hundreds, but there is certainly a group and it's growing. So I see our ability to use this going forward as something that we can continue to do and grow. Again, it's not going to be what we were at last cycle, but it should be very meaningful in helping us provide our balance sheet capital to grow our business.

David I. Goldberg
Analyst, UBS Securities LLC
Q

And just to tag on with that, is the cost of that capital pretty comparable or relative to the last cycle?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

It's a touch higher than it was before in the previous cycle, but not that much. And it's pretty much the same program that we were operating under previously.

David I. Goldberg
Analyst, UBS Securities LLC
Q

And then just as a follow-up question, Steve, I know you said you don't want to use this as an excuse in terms of labor market and labor shortages and that it feels a little bit more under control now certainly than it was nine months ago. But I want to kind of talk about, we've heard a lot of debate about labor in this cycle generally and I am just wondering if you kind of think about your experiences in up cycle, has there been a fundamental change in labor pool because of changes in immigration policy because of training for skilled labor that maybe hasn't happened in the last three years or four years. Do you think through the cycle labor shortages are fundamentally going to be a bigger or more significant or different kind of problem than they have been before or is this just kind of another up cycle to you?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

No, I think there has been some fundamental changes for all the reasons you mentioned. It's going to depend on what our government's policy is with regard to that going forward and then how efficient we can believe, how efficient we can become. I think we are constantly searching for methods to build our houses that require less labor and we are experimenting with a couple of those right now. But it's a long term challenge for the industry. There's not a lot of people that want to pour concrete in frame houses. So, some we think about it every day and we are working towards managing it better.

David I. Goldberg
Analyst, UBS Securities LLC

Q

Got you. And then can I just sneak one more in. Larry, on the tax rate and the lower kind of tax rate for the year 31%, 32% I think you said. Is that going to be persistently lower tax rate for the time being just given energy, credits and everything or is that going to be a kind of a 2013 event that will scale off as you move into 2014 and 2015?

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Well, next year will probably be a bit higher, but it will continue to be lower in the statutory rate. This year we had some catch up things, some discrete one-time items that we booked from last year because of changes in tax laws and those are kind of fixed in, as we've gone through the year. Those numbers as a percent of the total pre-tax income has reduced and that's why the tax rates have gradually gone up. But when you get to next year, you won't have those, but you will still have the ongoing energy tax credits Section 199 deductions, maybe reversals of state, Arizona and California State DTAs that haven't yet been booked. So you'll have some of those things continuing to bring the tax rate down some.

David I. Goldberg
Analyst, UBS Securities LLC

Q

I appreciate guys. Thank you.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Thanks.

Operator: [indiscernible] (48:05) at Credit Suisse.

Q

Thanks very much. I was wondering if you can talk a little bit about the comments in terms of the prices, the greater impact in terms of the overall trends, here in the Golden State clearly there've been the increases in terms of pricing and then we saw a corresponding lower absorption during the quarter, but you're still expecting a 5% to 7% increase in terms of pricing over time. Is it [indiscernible] (48:32) the third innings stretch or fourth innings stretch that we're going through right now, and that no sense in doing much in the way of incentives to try that, but do you think the pricing is going to come back over the next few months here and then in 2014?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Yes, I mean you pretty much said it. I think we still have a lot of the factors that pretend to a good housing market, very limited supply of resale homes, tight land conditions, high affordability, and all these factors are usually more so in California, and are going to lead to better appreciation in California than other markets around the country. So we're going to be very careful with their incentives and we're going to use incentives strategically. We certainly want to protect our backlog and we want to maintain our margins to the best degree that we can.

Q

Okay. And then secondly, I guess, you commented that there's been a response and I guess it relates to your confidence around the government shutdown and such and there's a real impact through the most recent sales. Anything you can say in terms of the first couple of weeks of [indiscernible] (49:53) over here, anything regionally in terms of just, how you're seeing those having an impact?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Overall, it's been pretty sluggish in October. I think we're going to finish October with less sales than we had in September. Seasonally, that's generally the case, but what's going on [indiscernible] (50:16) certainly hasn't helped our business at all.

Q

Okay. Thank you.

Operator: Our next question comes from Adam Rudiger at Wells Fargo.

Adam P. Rudiger
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. Thank you. Most of my questions have been asked. So, Steve, I'll ask you kind of a big picture crystal ball type question. Something I've been struggling with a little bit is we're hearing common themes from even lot of the other builders talking about this thing temporary blips or bumps on the road or kind of a choppy market in terms of a longer term improvement. I think we'd all agree that longer term supply-demand is pretty favorable couple of years out, but what gives you the confidence or the visibility as you see the next six months to nine months, maybe that, that this isn't the sluggishness or [ph] this malaise (51:00) we have seen isn't going to just going to continue. How do you think about the next six months, I guess?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Well, we still have pretty good traffic in our communities. We just don't have to see their urgency from buyers. We talk to buyers every day. When I go out to sales offices myself, I talk to buyers. And I know there is still a deep pool of people out there that want to buy a house, but the memory of what happened in 2005 and 2006 is still fresh in people's minds. And they saw prices shoot up very quickly and then they saw them go down very quickly and it was painful for a lot of people. So people want to make sure that this new level of pricing that we've achieved is going to stick. So they're going to wait two months or three months or four months before they pull the trigger and see what builders are going to do and what sellers are going to do, if there is going to be a flood of houses in the market, they are going to drive prices down. I don't see that happening. And I see buyers over the next several months, okay, it's safe, prices are steady, I'm going to buy a house. And I think by the time we get to February or so, we'll have four months or five months or six months that is behind us and people will start buying again at a higher pace. It's not like we're not selling any houses right now. We're still selling houses, but just the pace has cooled off a little bit. So, I think just being out in the field, talking to the potential customers and looking at traffic really makes us more positive.

Adam P. Rudiger
Analyst, Wells Fargo Securities LLC
Q

I think you've mentioned that you talk to buyers, and they want to buy a house, and there is a difference between wanting to buy a house and actually buying house or being able to buy a house. So moving into I guess mortgage financing or mortgage availability, what've you guys picked up on in terms of the ability of your buyers to qualify, how's that been changing and if at all.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

It hasn't really changed that much. I would say there has been more of a shift towards the conventional financing from FHA and VA. I think correct me if I'm wrong, Larry, 75% of our buyers today are using conventional financing. I think that was a little bit more close to 60% in quarter's path. And our down payments have actually risen from 11% to about 15% and credit scores have actually risen a little bit. So, again, we're not very big in the entry level space. So we're not a very good barometer for what's happening in there. But we're not finding a lot of buyers that are looking to buy mullet homes from us having mortgage issues per se.

Adam P. Rudiger
Analyst, Wells Fargo Securities LLC
Q

Okay. Great. Thanks for taking my questions.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Thank you.

Operator: Our next question comes from Eli Hackel at Goldman Sachs.

Eli C. Hackel
Analyst, Goldman Sachs & Co.
Q

Thanks. Just two quick questions. One, have you seen any impact in relation to loosening the lending standards. And then just on the municipalities that you said you've seen some backup. Has that been getting worse over the past couple of quarters and has that been concentrated in any regions around the country? Thanks.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Again, we haven't seen much change in the mortgage markets for our buyers. I'd say, yes, it has been getting a little bit worse over the last couple of few quarters dealing with cities and towns and it's become a bigger problem certainly in the West than in other parts of the country.

Eli C. Hackel
Analyst, Goldman Sachs & Co.
Q

Okay. Thank you very much.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Okay.

Operator: Our next question comes from Will Randow at Citi.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Hey, good morning and thanks for taking my question.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

Good morning.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Good morning.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Just two follow-up questions from before, in terms of lot prices we've been hearing, they're starting to plateau in areas like the Inland Empire. Are you seeing that at all?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Yes. I think, that's a safe assumption.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

And I guess, so which areas, in particular?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

I'd say across the country. I'd say pretty much everywhere.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Makes sense. And I guess, in regards to the government shutdown, were you seeing any hiccups or slowdown in FHA or FHFA ensured mortgages for the first few weeks of October?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Larry, did you hear anything on that. I didn't really. We heard that it was going to be potentially a problem if it lasted longer. I think we're right on the precipice of it impacting us, but I don't think we really felt much of an impact. [indiscernible] (56:10).

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.
A

Yes. The mortgage companies were closing with maybe a couple or two [ph] comp items (56:15) and the ultimate investors were willing to take the risk until the government opened back up and at some point, they would've stopped taking that risk, but it was a short enough period that it didn't affect our buyers' abilities to close.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

And if I could just sneak this last one in your [ph] Herkie Walls innovation (56:38). You haven't talked all that much about it, I know you mentioned it on a few calls. Can you talk about the cost benefit and how that improves the prior demand if that is the case or production time?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

It's still in the testing phase. And we're still experimenting with it. So, I really wouldn't want to give any more information about it yet, well certainly no more in the next couple of quarters and we can talk more about it then, but not really prepared to get into it too much more than we already have in previous quarters.

Will Randow
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Okay. Thanks again guys and congrats on the quarter.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Okay. Thank you.

Operator: Mr. Hilton, we're coming up to the hour point. We do have several more questions in the queue. Would you like to continue?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.
A

Yes. We will take a few more. Let's keep going.

Operator: Then our next question comes from Jay McCanless at Sterne, Agee.

Jay C. McCanless
Analyst, Sterne, Agee & Leach, Inc.
Q

Good morning, everyone. First question I had on taking the gross margin question in a different way. If you look outside of California, with the acquisitions you've done and the neighborhoods that you are opening, are you still seeing trends in the houses and what the buyers want in terms of larger square footage, higher amenities that might reverse the outlook you gave for gross margins?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Yes, I don't think it's going to have that much impact on gross margins. I think as interest rates rise, if they rise, it's going to have more of an impact on size than actual buying decision. And so at these low rates, people still want the big houses and we're selling at the larger end of our lineup in most communities and they want their options and upgrades. So I haven't seen much of a change in that area either and we certainly didn't experience a lot of change around the option strategy in the last cycle until things really fell off a cliff. So I expect it to remain pretty steady this cycle as well.

Jay C. McCanless
Analyst, Sterne, Agee & Leach, Inc.

Q

Okay. Second question is on active adult and you made a comment early in the call about Tucson. What are you hearing from the field and what are your people on the field telling you about buyer demand and why we haven't seen active adult maybe pickup as quick as some people [indiscernible] (59:09) anticipated?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

I wish I knew the answer to that. I certainly have my own theory on why active adult is not stronger. I think it's certainly because that passive income, a lot of active adult buyers depend upon is much lower than it's been because of the low interest rates and low savings return rates and they don't have the disposable income to buy a new home like they had in the last cycle. So that's impacted. It's a very, very small piece of our business. So it's really not that material for us, but I'd certainly like to see it improve and maybe it will improve as we get into next year. Tucson is a relatively good market. It's not quite as strong as Phoenix. The North side has performed better than the South side, but we still have very positive plans for Tucson going forward.

Jay C. McCanless
Analyst, Sterne, Agee & Leach, Inc.

Q

Okay. Great. Thank you.

Operator: Our next question comes from Alex Barron at Housing Research Center.

Alex Barron
Analyst, Housing Research Center LLC

Q

Hey, good morning. [indiscernible] (60:25) I wanted to ask you, Steve, in terms of the communities that you guys are raising prices once or not raising prices. What's your criteria for deciding whether to raise them or not? And also, what percentage of your communities would you say, you did raise prices this quarter versus what percentage do you keep on flat and were there any where you actually had to increase incentives or cut prices?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

I don't have the answer to the second part of your question. And I don't know if Larry wants to comment. But the first part, I guess is purely on what demand is in sales pace. So, if sales pace is exceeding three homes per month to four homes per month, we're going to try to push prices and if we have a lot of demand in, a deep pool buyers that want our homes, then we are going to try to get a little more price out of it. I would say, we also look at the competition to see how we price out against them. We certainly don't want to kill demand by overpricing our product and we're looking at what spread is between our homes and the resale homes in our area where we're building. So, there's a lot of things that go into the decision whether to raise prices or not, but it's mostly around demand.

Larry, do we have any stats on how many communities we've raised prices in and what [indiscernible] (61:58), I don't know if we want to give too much on the incentives.

Larry Wayne Seay
Chief Financial Officer & Executive Vice President, Meritage Homes Corp.

A

Yes, I don't think, we have any hard percentages, I would just say that price increases were much more modest the last few months and so, we don't have huge price increases like we were having for our quarters before that and then incentives, I don't think we really had any places where we had huge incentive increases, it's more of a modest incentive increase of 1% or 2% and a few are certainly within a cross the board kind of incentive increase, so I think, price increases were more modest and incentives were fairly modest where they were used.

Alex Barron
Analyst, Housing Research Center LLC

Q

Thanks.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Thanks. Operator, this will be our last question.

Operator: Our last question comes from Jade Rahmani at KBW.

Jade J. Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks for taking the question. Just wanted to ask about backlog conversion. I think in the past last quarter, I think you said in the high 60%s and you would like to keep it above 70%. What do you think a normalized rate is for your business say going into next year?

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

Well, Larry and I've been arguing about this a little bit. Larry is a little more conservative than I am and he believes this is going to fall more. I'd like to see it stay higher. I think a lot of it has to do with how many specs we have available, and we haven't been all the putters may expect out there over the last couple of quarters because demand for dirt sales as we call them, our new build has been very strong. But I think as things cool off a little bit, this last quarter we'll be able to get some more specs on the ground and that will help drive a better conversion rate in quarters to come. And you know it's also been a challenge getting permit in some places which has slowed things down as well. So, it's probably going to be tough to get back to 70%, but I hope we can keep it above 60%.

Jade J. Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Great. And just on the SG&A, I think on the commission percentage, I was wondering if there is a potential for that percentage to tick up based on higher payouts for sales people or increase marketing expense.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

A

It might tick up a touch. We've been using commissions as a little bit of tool to sell some houses this last quarter. So, there could be a small tick up there, but I don't think it's going to be that meaningful.

Jade J. Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. Thank you.

Steven J. Hilton
Chairman & Chief Executive Officer, Meritage Homes Corp.

Okay. Well, thank you very much everybody. We look forward to talking to you again next quarter. Appreciate your time and support. Good day.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.