

# MERITAGE CORPORATION

2000 ANNUAL REPORT



# overview

## *By Every Single Measure An Extraordinarily Successful Year*

*Meritage Corporation designs, sells and constructs homes. The company provides single-family residences for first-time, move-up and luxury buyers in eight high-growth areas in Texas, Arizona and California. The year 2000 has proved a remarkable one for Meritage Corporation. The investment in growth made over the last few years has shown a substantial return in 2000 as Meritage has exceeded every goal set for 2000. To highlight the extraordinary results realized last year, the company produced record sales, profits and backlog that far outpaced expectations:*

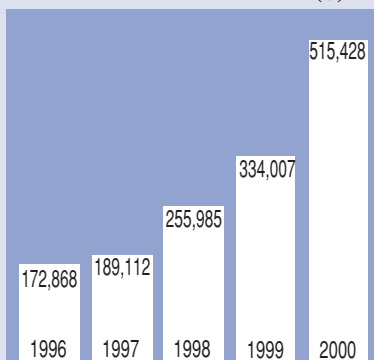
- Home deliveries increased 36% and grew to 2,227 from 1,643 in 1999,
- Closing revenue increased 54% to \$515 million from \$334 million in 1999,
- Net income increased 89% to \$35.8 million from \$18.9 million in 1999 and
- Backlog grew to 1,246 units from 885 units in 1999, an increase of 41%.

Additionally, the company opened for sales in 24 new communities, inventoried 2,474 home sites for future growth and continued to build high-quality homes in economically vibrant communities for its customers while delivering extraordinary value to shareholders.



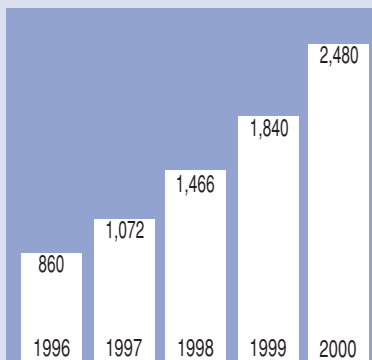
(dollars in thousands)

### Home Sales Revenue (\$)



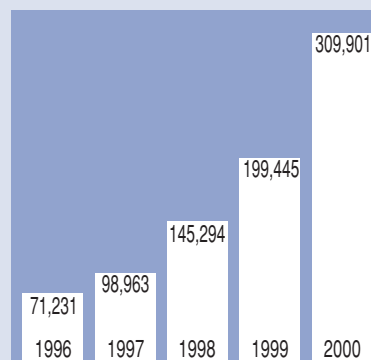
Home sales revenue grew an extraordinary 54% in 2000, topping even the most optimistic projections and illustrating Meritage's success in selling homes at the "right price." For the last five years, the compounded annual growth rate is 31%.

### Homes Ordered



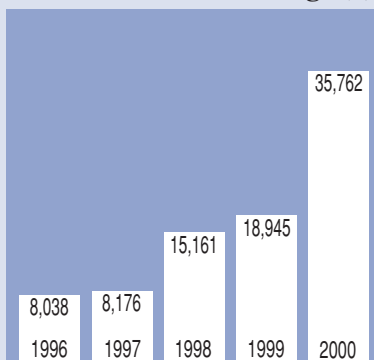
The number of homes ordered increased to 2,480 in 2000, reflecting Meritage's goal to deliver the "right product" to its customers. As a result of successful expansion over the past five years, the compounded annual growth rate is 25%.

### Sales Backlog (\$)



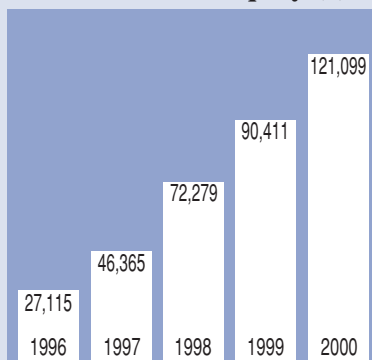
With the highest backlog in its history of 1,246 homes at year end, Meritage is realizing its goal of selling homes in the "right location." The dollar value of \$309,901 million in backlog means Meritage is poised for a sound 2001.

### Pro Forma Net Earnings (\$)



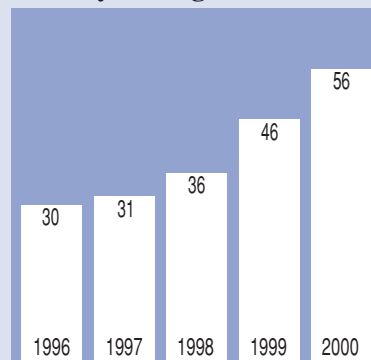
Meritage's pro forma net earnings in 2000 increased 89% over 1999 with pre-tax net margins expanding to 11%, well above industry standards. For the past five years, the compounded annual growth rate is 36%.

### Shareholders' Equity (\$)



In 2000, shareholders' equity increased 34% over 1999 confirming that Meritage delivers to its customers and its shareholders. In just four years, shareholders' equity has expanded 347% to over \$121 million.

### Actively Selling Communities



Meritage now builds in 56 neighborhoods in eight economically vibrant metropolitan markets. Sales activity in these communities demonstrates that Meritage continues to provide the right product in the right location at the right price.

See notes on the Financial Highlights page regarding the historical data presented above.

# to our shareholders



By every single measure, 2000 was an extraordinarily successful year for all of us at Meritage Corporation.

Results exceeded our highest expectations, as Meritage Corporation achieved its 13th consecutive year of record-setting revenues and profits. We also ended the year with the highest backlog in our history, giving us a strong starting position entering 2001. Further, we set the stage for future growth by expanding into new markets, opening additional offices and acquiring land and lots for tomorrow. And of special interest to you, we experienced a rise in our stock price of approximately 243%.



The company's performance in 2000 reached levels beyond our most optimistic projections. As in previous years, we attribute this superior achievement to keeping a determined focus on Meritage's core

home-building strategy: to provide the right product in the right location at the right price.

## *The Right Product*

Year after year we continue to deliver distinctive homes that welcome buyers with design flair and exceptional value without sacrificing quality. To create the right product means using and becoming experts on housing, decorating and lifestyle trends, while continually refining our home plans to complement the dynamics of those market segments we target. We depend upon hands-on local management as a touchstone for the characteristics that differentiate each city and community. A direct and close link such as this, along with the flexibility to adapt to market changes enables us to deliver product that hits the mark. As the photographs throughout this annual report illustrate, we put the sizzle where it counts: in dramatic entries, spa-like baths, state-of-the-art kitchens and attractive details like moldings and curved ceilings. All told, we built more than 2,200 new homes in 2000, each reflecting the style and distinction for which Meritage has become known.





## *The Right Location*

The right location for Meritage starts with Texas, Arizona and Northern California, all states with vibrant economies that are growing with us. In fact, job growth and the migration of home buyers into these areas have remained above the national average, an advantage for any expansion plan. We operate, by design, in markets where the supply and demand for housing remains in balance and demographic trends support growth. While a general economic slowdown is a possibility in 2001, market analysts and economists have



predicted Texas and the West to outperform the national economy.

Under the brand name Legacy Homes, we have become one of the largest builders in Texas by successfully targeting value-oriented buyers in Dallas/Fort Worth, Houston and Austin. A new office was established in Fort Worth in 2000 to accommodate our recent growth and future expansion plans in that area. In Austin, we set the stage to expand into the semi-custom market through the purchase of lakeside lots.

been recognized as a premier builder of semi-custom luxury homes in affluent Scottsdale, and in 2000 began its expansion into other Phoenix suburbs. Meritage Homes in Phoenix is rapidly spreading operations to communities throughout the greater metropolitan area, featuring mid-priced homes to complement the Monterey line. In

In Arizona, we operate using both the Monterey Homes and Meritage Homes brand names. Monterey Homes has long

Tucson, Monterey Homes offers homes in a broad price band, expanded significantly in 2000 through the acquisition of four existing communities from a competing builder.



Building in the San Francisco Bay and Sacramento areas as Meritage Homes, we specialize in single-family, first and second move-up homes. Since 1998, we have grown dramatically in this region, increasing our closing revenue by 227% over that first full year. The substantial growth in our Sacramento operations dictated the opening of a new division office there in 2000.



Equally important, the right location also means the right submarkets within each metropolitan area, and furthermore, the right community within those submarkets. Our criteria for purchasing land and home sites are stringent. We demand that each location meet our suitability tests for price and terms, building constraints and consumer desirability and acceptance.



And finally, our conservative approach to land management is a key factor in our location equation. Instead of acting as a speculator by buying large tracts of land, we option our lots through third-party landowners. In this way, we secure availability, keep the majority of the lots off our balance sheet and thus generate profits from home building and not from risky land speculation.

## *The Right Price*

Our increased sales and profits in 2000 both stem from offering our quality homes at the right price. Constant monitoring and controls on many fronts mean we are able to price our product competitively to generate sales velocity, while managing our expenses to result in an impressive bottom line. This can be a tricky balancing act for any company, and keeping this balance is a number one priority for Meritage. Again, our hands-on local management teams become the experts. From sales managers to division presidents, all eyes are on the pricing strategies of our competition and the price-acceptance of the consumer. All hands are ready to ensure that we keep our homes priced attractively. This of course takes intense effort by our estimating, budgeting and purchasing personnel who work with our subcontractors and vendors to control the construction cost of our homes. Together they work in an entrepreneurial manner, but under strict corporate guidelines to ensure that we are able to achieve the right price.



## *The Results Are Telling*

The millennium year also brought a maturation for Meritage Corporation, and this too became a factor in our extraordinary success. Our divisions in Northern California and Phoenix made a greater contribution to our bottom line. A number of highly desirable communities moved from the drawing board to reality, with a positive impact on our overall numbers. Our culture has become

more ingrained in our newer division presidents, making them more effective in operating the Meritage way. And as we grow, we are witnessing greater synergy among our divisions across the country.

Along with these factors, and perhaps more important, our success is attributable to the quality of our management and employees, and our vendor/subcontractor partners. We believe our employees to be among the most productive in the industry, each generating on average \$1.43 million in revenue in 2000. Without their superior efforts, such extraordinary levels of success would have been unobtainable.

As a result, revenues from home building grew 54% to a record \$515 million from \$334 million in 1999. Also, net income grew to a record \$35.8 million, or \$6.26 per diluted share, in 2000, compared with \$18.9 million, or \$3.14 per diluted share, in 1999. Additionally, our earnings per share improved through the company's repurchase of 11% of the shares that were outstanding at the beginning of 2000.

But the records didn't stop there. In fact, we are extremely happy to report that we achieved this extraordinary top line growth while improving margins. During 2000, gross margins grew to 20% from 19% in 1999 and operating margins grew to 11% from 10%.

In addition, our return on assets increased to 26.6% from 18.1% and our return on equity grew to 33.8% from 23.0%, as we continued to outperform the industry in these areas.

The recognition of our success moved beyond our immediate markets this year when the company was featured by several national publications. Both *Builder* magazine and *Professional Builder* listed Meritage as one of the country's Top 100 Builders and Housing Giants, respectively. *Fortune* magazine ranked Meritage for the second year as one of the



100 fastest growing companies in the U.S., with the added distinction of being No. 1 in revenue growth and No. 6 in earnings growth. Extraordinary indeed.



## 2001: The Future

As we go forward into 2001, we must be acutely aware of the economic environment and how it may impact the housing industry. As always, we shall approach the year striving to keep reasonable debt-to-capital ratios, to grow our business and to add value for our customers and our shareholders. We shall continue to operate being cautiously aggressive and prudent, building a company that can succeed in varying economic climates. Our record backlog of \$310 million on 1,246 homes at the end of 2000 suggests continued success in this year as well. And our inventory of approximately 7,500 lots under control provides a healthy supply to help execute our business plan in the years ahead. Additionally, we will seek out opportunities for expansion in current markets and scout out new regions that have the economic fundamentals to grow with us.

In any event, we believe 2001 will be another good year for Meritage. Although we expect less dramatic increases than those of 2000, our goal remains the same for 2001: to build the right product in the right location at the right price. We believe that by focusing on this goal, we can continue to deliver extraordinary homes to our customers and extraordinary value to our shareholders.



Steven J. Hilton  
*Co-Chairman and  
Chief Executive Officer*



John R. Landon  
*Co-Chairman and  
Chief Executive Officer*



# texas

## LEGACY HOMES

	DALLAS/FT. WORTH	AUSTIN	HOUSTON
Years of operation	13	7	3
Primary design	Starter, 1st and 2nd Move-Up	1st Move-Up	1st and 2nd Move-Up
Average sales price	\$177,000	\$166,000	\$165,000
Average square feet	2,750	2,300	2,500
Homes closed (increase over '99)	808 (3%)	300 (15%)	131 (51%)
Homes ordered (increase over '99)	879 (5%)	328 (18%)	161 (96%)
Sales backlog at 12/31/00 (increase over '99)	498 (17%)	135 (26%)	62 (94%)
Lots under control at 12/31/00	3,146	559	530
Number of active communities	15	5	5

*Eleven new Dallas/Ft. Worth, six additional Austin, and four additional Houston communities are in various stages of development and are planned to open for sales during 2001.*

## MARKET GROWTH TRENDS\*

Population five-year change	+13%	+19%	+11%
Job growth annual rate (last four quarters)	+3.9%	+5.0%	+2.8%
2000 single family building permits	36,067	9,584	27,729

\* Source: U.S. Housing Markets Research Report, published by The Meyers Group



## LEGACY HOMES - TEXAS

Since its 1987 founding, Legacy Homes has carved a sizeable niche in the Texas housing market by offering high-value, dramatic homes in family-oriented neighborhoods. The company is known for its ability to incorporate design features found in more expensive custom homes within price parameters affordable to first and second move-up buyers. Operating in Dallas, Fort Worth, Houston and Austin, Legacy Homes is ranked among the top ten home builders in Austin and the

Dallas/Ft. Worth metroplex and considered one of the top builders in the state of Texas.



*Stewart H. Parker  
President  
Legacy Homes  
Dallas/Ft. Worth Division*



*Richard V. Harvey  
President  
Legacy Homes  
Austin Division*



*Michael J. Pizzitola  
President  
Legacy Homes  
Houston Division*



# arizona

## MONTEREY HOMES / MERITAGE HOMES

	MONTEREY PHOENIX	MERITAGE PHOENIX	MONTEREY TUCSON
Years of operation	16	1	5
Primary design	Semi-Custom Luxury	1st and 2nd Move-Up	Semi-Custom Luxury 1st & 2nd Move-Up
Average sales price	\$487,000	\$229,000	\$180,000
Average square feet	3,500	2,700	2,200
Homes closed (increase over '99)	184 (6%)	142 (190%)	297 (67%)
Homes ordered (increase over '99)	192 (8%)	168 (171%)	283 (44%)
Sales backlog at 12/31/00 (increase over '99)	134 (24%)	81 (47%)	129 (143%)
Lots under control at 12/31/00	379	875	574
Number of active communities	7	6	11

*One new Monterey Phoenix, three additional Tucson, and six additional Meritage Phoenix communities are in various stages of development and are planned to open for sales during 2001.*

### MARKET GROWTH TRENDS\*

Population five-year change	+16%	+8%
Job growth annual rate (last four quarters)	+3.4%	+2.3%
2000 single family building permits	34,089	5,857

\* Source: U.S. Housing Markets Research Report, published by The Meyers Group



## MONTEREY HOMES / MERITAGE HOMES - ARIZONA

Throughout Arizona, Meritage brings a strong commitment to quality and craftsmanship that has satisfied customers for over 15 years. Founded in 1985, the company now operates in Phoenix, Scottsdale and Tucson as three distinctively different divisions. Monterey Homes of Phoenix has long been the flagship, building luxurious residences directed to affluent buyers in prestigious communities like Scottsdale. Meritage Homes Phoenix



*David A. Walls  
President  
Monterey Homes  
Phoenix Division*



*J. Patrick Moroney  
President  
Meritage Homes  
Phoenix Division*



*Jeffrey R. Grobstein  
President  
Monterey Homes  
Tucson Division*

complements Monterey by offering mid-priced homes in surrounding suburban areas. And in Tucson, Monterey Homes provides a wide variety of homes designed for first move-up to luxury buyers.



# california

## MERITAGE HOMES

Years of operation

Primary design

Average sales price

Average square feet

Homes closed (increase over '99)

Homes ordered (increase over '99)

Sales backlog at 12/31/00 (increase over '99)

Lots under control at 12/31/00

Number of active communities

## SAN FRANCISCO BAY

2

1st and 2nd  
Move-Up

\$336,000

2,700

247 (518%)

320 (230%)

142 (318%)

775

4

## SACRAMENTO

2

1st and 2nd  
Move-Up

\$358,000

3,200

118 (74%)

149 (37%)

65 (-6%)

620

3

*Four new San Francisco Bay and three additional Sacramento communities are in various stages of development and are planned to open for sales during 2001.*

## MARKET GROWTH TRENDS\*

Population five-year change

+6%

+9%

Job growth annual rate (last four quarters)

+4.6%

+3.9%

2000 single family building permits

16,286

13,438

\* Source: U.S. Housing Markets Research Report, published by The Meyers Group



## MERITAGE HOMES - NORTHERN CALIFORNIA

Meritage Homes in Northern California has built a strong core operation in the highly desirable San Francisco and Sacramento markets building single-family, first and second move-up homes. Although having only joined the Meritage team in 1998, each member of the California senior management team has more than two decades experience in the industry. Over the past two and one-half years, the Northern California region has developed a solid inventory of home sites and created new series of home designs specifically to meet Northern California buyer preferences. The Northern California divisions boast the highest increase in revenues of any Meritage divisions during 2000, and are a testament to the company's expansion strategy.



*Steven W. Hafener  
Regional President  
Meritage Homes  
Northern California*



*Michael V. Anderson  
President  
Meritage Homes  
Sacramento Division*



# highlights

## Financial Highlights - Unaudited

(dollars in thousands)

	<u>2000</u>	<u>1999</u>	<u>1998*</u>	<u>1997*</u>	<u>1996*</u>
<b>I. Income Statement Data</b>					
Home sales revenue					
Texas	\$214,472	\$174,850	\$130,860	\$ 91,190	\$ 85,114
Arizona	175,674	120,909	105,942	97,922	87,754
California	<u>125,282</u>	<u>38,248</u>	<u>19,183</u>	<u>—</u>	<u>—</u>
Total	<u>\$515,428</u>	<u>\$334,007</u>	<u>\$255,985</u>	<u>\$189,112</u>	<u>\$172,868</u>
Home sales gross margin	20.2%	19.1%	20.1%	16.0%	16.5%
Earnings before interest & taxes	\$ 65,941	\$ 37,258	\$ 34,580	\$ 24,208	\$ 18,622
Reported net earnings	35,762	18,945	24,003	14,237	13,396
Pro forma net earnings**	35,762	18,945	15,161	8,176	8,038
Pro forma net margin**	6.9%	5.5%	5.9%	4.3%	4.6%
<b>II. Operating Data</b>					
Average sales price of homes closed					
Company-wide	\$ 231	\$ 203	\$ 198	\$ 206	\$ 186
Texas	173	154	140	144	137
Arizona	282	302	334	345	286
California	343	354	457	—	—
Homes closed	2,227	1,643	1,291	917	930
Homes ordered	2,480	1,840	1,466	1,072	860
Dollar value of homes ordered	\$604,444	\$388,158	\$283,746	\$214,468	\$174,186
Sales backlog	1,246	885	688	472	317
Dollar value of sales backlog	\$309,901	\$199,445	\$145,294	\$ 98,963	\$ 71,231
Actively selling communities	56	46	36	31	30
<b>III. Balance Sheet Data</b>					
Real estate under development	\$211,307	\$171,012	\$104,759	\$ 63,955	\$ 56,894
Total assets	267,075	226,559	152,250	96,634	86,226
Notes payable	86,152	85,937	37,205	22,892	38,381
Stockholders' equity	121,099	90,411	72,279	46,365	27,115
<b>IV. Return Data***</b>					
Return on average assets	26.6%	18.1%	23.7%	21.5%	25.2%
Return on average equity	33.8%	23.0%	25.6%	22.3%	35.1%

\* Historical data reflects the combination of Monterey Homes ("Monterey"), Legacy Homes ("Legacy") and Homeplex Mortgage Investments Corporation ("Homeplex"). Information for 1996 and 1997 is pro forma to reflect the merger between Monterey and Homeplex and the combination with Legacy as if both had occurred on January 1, 1996.

\*\* Pro forma net earnings excludes income and gains from residual and loan assets which were sold during 1997 and 1998 and the benefit from Meritage's net operating loss carryforward, while including the operations of Legacy for the full year of 1997.

\*\*\* Return on average assets is defined as pro forma net earnings before income taxes and interest divided by average total assets for the year. Return on average equity is defined as pro forma net earnings divided by average stockholders' equity.



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**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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**FORM 10-K**

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

For the fiscal year ended December 31, 2000

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-9977

**MERITAGE CORPORATION**

(Exact Name of Registrant as specified in its charter)

Maryland 86-0611231  
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

6613 North Scottsdale Road, Suite 200 85250  
Scottsdale, Arizona (Zip Code)  
(Address of principal executive offices)

(480) 998-8700  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act  
Common Stock, \$.01 par value New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

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 X No \_\_\_

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

At March 15, 2001 the aggregate market value of common stock held by non-affiliates of the Registrant was \$55,588,139. For purposes of this computation, all executive officers and directors of the Registrant have been deemed to be affiliates.

The number of shares outstanding of the Registrant's common stock on March 15, 2001 was 5,941,202.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions from the Registrant's Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 9, 2001 have been incorporated by reference into Part III, Items 10, 11, 12 and 13.

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## PART I

### Item 1. Business

#### *History of the Company*

Meritage Corporation designs, constructs and sells single-family homes ranging from entry-level to semi-custom luxury. We currently operate in three large and growing Sunbelt states: Texas, Arizona and California. At December 31, 2000, we were actively selling homes in 56 communities. Information about our active communities is provided through our Internet web site at [www.meritagecorp.com](http://www.meritagecorp.com).

We were formed in 1988 as a real estate investment trust (“REIT”) and operated under the name of Homeplex Mortgage Investments Corporation. Homeplex invested in mortgage-related assets and selected real estate loans. On December 31, 1996, the Company acquired by merger the homebuilding operations of various entities using the Monterey Homes name (the “merger”). Following the merger we changed our name to Monterey Homes Corporation, focused on our homebuilding operations and began to diversify our geographic scope and product mix through internal growth and acquisitions. In this regard, on July 1, 1997, we combined with Legacy Homes, a group of entities with homebuilding operations in Texas since 1988. In July 1998, we acquired Sterling Communities, a homebuilder in Northern California. With shareholder approval, Meritage Corporation became our new corporate name in September 1998. Operations continue in Texas under the Legacy Homes name, in Arizona as Monterey Homes and Meritage Homes of Arizona, and in Northern California as Meritage Homes.

#### *Business Strategy*

We seek to distinguish ourselves from other production homebuilders and to respond rapidly to changing market conditions through a business strategy focused on the following:

*Superior Design and Quality.* We believe we maximize customer satisfaction by offering homes that are built with quality materials and craftsmanship, exhibit distinctive design features and are situated in premium locations. We believe that we generally offer higher caliber homes in their defined price range or category compared to those built by our competitors.

*Highest Level of Service.* We are committed to achieving the highest level of customer satisfaction as an integral part of our competitive strategy. During the sales process our experienced sales personnel keep customers informed of their home’s construction progress. After delivery, our customer care departments respond to any questions or warranty matters a customer may have.

*Product Breadth.* We design our homes to appeal to a wide variety of consumers. In Texas, we target entry-level and move-up buyers, offering homes at prices that reflect the production efficiencies of a high-volume tract builder. In Arizona, we focus on the luxury market, which is characterized by unique communities and distinctive luxury homes, and the move-up homebuyers’ market. We are continuing our expansion into the first and second-time move-up segments of the Arizona market to increase our share of the overall housing market in the Phoenix and Tucson metropolitan areas. In Northern California, we focus on building quality first and second-time move-up homes. We believe this product breadth and geographical diversity helps to reduce exposure to variable economic cycles, which enhances our growth potential.

*Conservative Land Acquisition Policy.* We seek to maximize our return on capital employed by practicing a conservative land acquisition policy that minimizes risks associated with land investment. We accomplish this by:

- focusing on development sites where we expect to have less than a three-year lot inventory;
- generally purchasing land subject to complete entitlement, including zoning and utility services; and

- controlling lots on a non-recourse, rolling option basis where we have the right, but not the obligation, to buy lots at predetermined prices based on a takedown schedule that reflects anticipated home closings.

We generally do not speculate in raw land held for investment.

*Cost Management.* Throughout our history, we have focused on controlling costs and minimizing overhead, and consider this a key factor in maintaining profitability. Management seeks to reduce costs by:

- using subcontractors to carry out home construction and site improvement on a fixed-price basis;
- obtaining favorable pricing from subcontractors through long-term relationships and large volume jobs;
- reducing interest carry by minimizing our inventory of unsold or speculative homes and shortening the home construction cycle;
- generally beginning construction on a home under contract only after a satisfactory down payment and/or receipt of mortgage approval has been received from the buyer;
- minimizing overhead by centralizing certain administrative activities; and
- maintaining management information systems to allow the monitoring of homebuilding production, scheduling and budgeting.

*Decentralized Operating Structure with Experienced Division Managers.* We rely upon the expertise of divisional managers, each with significant experience in the homebuilding industry, to serve the needs of our regional markets. Corporate-level management provides centralized control for risk elements such as land acquisition approval, financing, cash management, capital allocation and risk management.

*Expansion in New and Existing Markets.* Depending on market conditions, we may explore expansion opportunities in new or existing geographic areas where we see an ability to exploit a competitive advantage. Expansion may take place through strategic acquisitions of existing homebuilders, through start-up operations or through internal growth.

### **Markets and Products**

We operate in the Dallas/Fort Worth, Austin and Houston, Texas markets using the Legacy Homes brand name, in the Phoenix, Scottsdale and Tucson, Arizona markets as Monterey Homes and Meritage Homes and in the San Francisco Bay and Sacramento, California markets as Meritage Homes. We believe that these areas represent attractive homebuilding markets with opportunities for long-term growth. We also believe that our operations in certain markets, such as Dallas/Fort Worth, Phoenix and Scottsdale, are well established and that we have developed a reputation for building distinctive quality homes within the market segments served by these communities.

Our homes range from entry-level to semi-custom luxury, with base prices ranging from \$100,000 to \$775,000. A summary of activity by market and product type follows (dollars in thousands):

	<u>Number of Homes Closed in 2000</u>	<u>Average Closing Price</u>	<u>Units in Backlog at Year End</u>	<u>Dollar Value of Backlog at Year End</u>	<u>Home Sites Remaining<sup>(1)</sup></u>	<u>Number of Active Communities</u>
Texas – Move-up	922	\$184	471	\$86,222	2,918	16
Texas – Entry-level	317	142	224	33,342	1,258	9
Arizona - Luxury	231	449	157	77,651	319	10
Arizona - Move-up	392	183	187	37,560	1,390	14
California – Move-up	<u>365</u>	343	<u>207</u>	<u>75,126</u>	<u>1,321</u>	<u>7</u>
Total Company	<u>2,227</u>	\$231	<u>1,246</u>	<u>\$309,901</u>	<u>7,206</u>	<u>56</u>

(1) “Home Sites Remaining” is the number of homes that could be built both on the remaining lots available for sale and land to be developed into lots as estimated by management.

## *Land Acquisition and Development*

We typically purchase land only after necessary entitlements have been obtained so that development or construction may begin as market conditions dictate. The term “entitlements” refers to development agreements, tentative maps or recorded plats, depending on the jurisdiction within which the land is located. Entitlements generally give the developer the right to obtain building permits upon compliance with conditions that are ordinarily within the developer’s control. Even though entitlements are usually obtained before land is purchased, we are still required to secure a variety of other governmental approvals and permits during development. The process of obtaining such approvals and permits can substantially delay the development process. For this reason, we may consider purchasing unentitled property in the future when we can do so in a manner consistent with our business strategy.

We select land for development based upon a variety of factors, including:

- internal and external demographic and marketing studies;
- project suitability, which is generally a development with fewer than 150 lots;
- suitability for development generally within a one to three year time period from the beginning of the development process to the delivery of the last home;
- financial review as to the feasibility of the proposed project, including projected profit margins, return on capital employed, and the capital payback period;
- the ability to secure governmental approvals and entitlements;
- results of environmental and legal due diligence;
- proximity to local traffic corridors and amenities; and
- management’s judgment as to the real estate market, economic trends, and experience in a particular market.

We occasionally purchase larger properties consisting of 200 to 500 lots or more if the situation presents an attractive profit potential and acceptable risk limitations.

We acquire land through purchases and rolling option contracts. Purchases are financed through traditional bank financing or working capital. Rolling options allow us to control lots and land through a third party who owns or buys the property on which we plan to build homes. We enter into option contracts with the third party to purchase finished lots as home construction begins. These contracts are generally non-recourse and require non-refundable deposits of 2% to 15% of the sales price. We acquire a majority of our land through rolling option contracts. At December 31, 2000, we had approximately \$24.3 million in deposits on real estate under option or contract.

Once we have acquired land, we generally initiate development through contractual agreements with subcontractors. These activities include site planning and engineering, as well as constructing road, sewer, water, utilities, drainage, recreation facilities and other refinements. We often build homes in master planned communities with home sites that are along or near a major amenity, such as a golf course.

We develop a design and marketing concept for each project, which includes determination of size, style and price range of homes, street layout, size and layout of individual lots, and overall community design. The product line offered in a particular project depends upon many factors, including the housing generally available in the area, the needs of a particular market, and our lot costs for the project.

Occasionally we use partnerships or joint ventures to purchase and develop land where these arrangements are necessary to acquire the property or appear to be otherwise economically advantageous.

The following table presents information regarding land owned or land under contract or option by market as of December 31, 2000:

	<u>Land Owned (1)</u>			<u>Land Under Contract or Option (1)</u>		<u>Total</u>
	<u>Finished Lots</u>	<u>Lots Under Development (estimated)</u>	<u>Lots Held for Development (estimated)</u>	<u>Finished Lots</u>	<u>Lots Under Development (estimated)</u>	
<b>TEXAS:</b>						
Dallas/Ft. Worth Area	698	900	---	249	1,299	3,146
Austin Area	19	---	---	40	500	559
Houston Area	<u>166</u>	<u>---</u>	<u>---</u>	<u>---</u>	<u>364</u>	<u>530</u>
Total Texas	<u>883</u>	<u>900</u>	<u>---</u>	<u>289</u>	<u>2,163</u>	<u>4,235</u>
<b>ARIZONA:</b>						
Phoenix Area	203	238	---	402	411	1,254
Tucson Area	<u>182</u>	<u>---</u>	<u>---</u>	<u>160</u>	<u>232</u>	<u>574</u>
Total Arizona	<u>385</u>	<u>238</u>	<u>---</u>	<u>562</u>	<u>643</u>	<u>1,828</u>
<b>CALIFORNIA:</b>						
Sacramento Area	34	---	---	188	476	698
San Francisco Bay Area	<u>34</u>	<u>---</u>	<u>77</u>	<u>130</u>	<u>456</u>	<u>697</u>
Total California	<u>68</u>	<u>---</u>	<u>77</u>	<u>318</u>	<u>932</u>	<u>1,395</u>
<b>TOTAL COMPANY</b>	<u>1,336</u>	<u>1,138</u>	<u>77</u>	<u>1,169</u>	<u>3,738</u>	<u>7,458</u>

(1) Excludes lots with finished homes or homes under construction.

### ***Construction***

We are the general contractor for our projects and typically hire subcontractors on a project-by-project or reasonable geographic proximity basis to complete construction at a fixed price. We usually enter into agreements with subcontractors and materials suppliers after receiving competitive bids on an individual basis. We obtain information from prospective subcontractors and suppliers with respect to their financial condition and ability to perform their agreements before formal bidding begins. Occasionally, we enter into longer-term contracts with subcontractors and suppliers if management can obtain more favorable terms. Our project managers and field superintendents, who coordinate and supervise the activities of subcontractors and suppliers, subject the work to quality and cost controls, and assure compliance with zoning and building codes.

We specify that quality, durable materials be used in construction of our homes and we do not maintain significant inventories of construction materials, except for work in process materials for homes under construction. When possible, management negotiates price and volume discounts with manufacturers and suppliers on behalf of its subcontractors to take advantage of production volume. Usually, access to our principal subcontracting trades, materials and supplies is readily available in each of our markets. Prices for these goods and services may fluctuate due to various factors, including supply and demand shortages that may be beyond the control of our vendors. We believe that our relationships with suppliers and subcontractors are good.

We generally build and sell homes in clusters or phases within a project, which management believes creates efficiencies in land development and construction, and improves customer satisfaction by reducing the number of vacant lots surrounding a completed home. A typical Meritage home is completed within four to ten months from the start of construction, depending upon home size and complexity. Schedules may vary depending on the availability of labor, materials and supplies, product type, location and weather. Our homes are usually designed to promote efficient use of space and materials, and to minimize construction costs and time.

## ***Marketing and Sales***

We believe that we have an established reputation for developing high quality homes, which helps generate interest in each new project. We also use advertising and other promotional activities, including magazine and newspaper advertisements, brochures, direct mail, and the placement of strategically located signs in the immediate areas of our developments.

We use furnished model homes as tools in demonstrating the competitive advantages of our home designs and various features to prospective homebuyers. We generally employ or contract with interior designers who are responsible for creating an attractive model home for each product line within a project. We generally build between one and four model homes for each active community, depending upon the number of homes to be built in the project and the products to be offered. Typically, we sell our model homes and lease them back from buyers who purchased the homes for investment purposes or who do not intend to move in immediately. A summary of model homes owned or leased at December 31, 2000 follows:

	<u>Model Homes Owned</u>	<u>Model Homes Leased Back</u>	<u>Monthly Lease Amount</u>	<u>Models Under Construction</u>
Texas	30	---	---	10
Arizona	5	43	\$ 128,100	13
California	<u>6</u>	<u>18</u>	<u>61,200</u>	<u>6</u>
Total	<u>41</u>	<u>61</u>	<u>\$ 189,300</u>	<u>29</u>

Our homes generally are sold by full-time, commissioned employees who typically work from a sales office located in the model homes for each project. Our goal is to ensure that the sales force has extensive knowledge of our operating policies and housing products. To achieve this goal, we train our sales personnel and conduct periodic meetings to update them on sales techniques, competitive products in the area, financing availability, construction schedules, marketing and advertising plans, and the available product lines, pricing, options, and warranties offered. Sales personnel are licensed real estate agents where required by law. Independent brokers also sell our homes, and are usually paid a sales commission based on the price of the home.

Occasionally we offer various sales incentives, such as landscaping and certain interior home improvements, to attract buyers. The use and type of incentives depends largely on economic and competitive market conditions.

## ***Backlog***

Most of our home sales are made under standard sales contracts signed before construction of the home begins. The contracts require substantial cash deposits and are usually subject to certain contingencies such as the buyer's ability to qualify for financing. Homes covered by such sales contracts but not yet closed are considered "backlog". We do not recognize revenue on homes in backlog until the home is delivered to a third-party homebuyer and other criteria for sale and profit recognition are met. We sometimes build homes in a community before obtaining a sales contract, however, these homes are excluded from backlog until a sales contract is signed. We believe we will deliver almost all homes in backlog at December 31, 2000 to customers during 2001.

Our backlog increased to 1,246 units with a value of \$309.9 million at December 31, 2000 from 885 units with a value of \$199.4 million at December 31, 1999. These increases are primarily due to additional communities that opened for sale in 2000, along with strong home sales in 2000, in all of our markets.

## ***Customer Financing***

We attempt to help qualified homebuyers who require financing to obtain loans from mortgage lenders that offer a variety of financing options. We provide mortgage-banking services in our Dallas/Fort Worth markets through a 100% owned mortgage lending company, Texas Home Mortgage Corporation, which originates loans on behalf of third party lenders. In Phoenix and Tucson we provide mortgage services through MTH Mortgage, LLC, a joint venture with an independent mortgage banking company. In our other markets we use unaffiliated preferred mortgage lenders. We may pay a portion of the closing costs and discount mortgage points to assist homebuyers with financing. Since many customers use long-term mortgage financing to purchase homes, adverse economic conditions, unemployment increases and high mortgage interest rates may deter or reduce the number of potential homebuyers.

## ***Customer Relations, Quality Control and Warranty Programs***

We believe that positive customer relations and an adherence to stringent quality control standards are fundamental to continued success, and that our commitment to buyer satisfaction and quality control has significantly contributed to our reputation as a high quality builder.

A Meritage project manager or project superintendent, and a customer relations representative generally oversee compliance with quality control standards for each development. These representatives allocate responsibility to:

- oversee home construction;
- oversee subcontractor and supplier performance;
- review the progress of each home and conduct formal inspections as specific stages of construction are completed; and
- regularly update buyers on the progress their homes.

We generally provide a one-year limited warranty on workmanship and building materials with each home. Subcontractors usually provide an indemnity and a certificate of insurance before they begin work, therefore claims relating to workmanship and materials are generally the subcontractors' primary responsibility. Reserves for future warranty costs are established based on historical experience within each division or region, and are recorded when the homes are delivered. Reserves range from 3/10 of one per cent to 3/4 of one percent of a home's sale price. To date, these reserves have been sufficient to cover warranty repairs.

## ***Competition and Market Factors***

The development and sale of residential property is a highly competitive industry. We compete for sales in each of our markets with national, regional, and local developers and homebuilders, existing home resales, and to a lesser extent, condominiums and available rental housing. Some competitor homebuilders have significantly greater financial resources and/or lower costs than we do. Competition among both small and large residential homebuilders is based on a number of interrelated factors, including location, reputation, amenities, design, quality and price. We believe that we compare favorably to other homebuilders in the markets in which we operate due to our:

- experience within our geographic markets which allows us to develop and offer new products;
- ability to reflect and adapt to changing market conditions;
- ability, from a capital and resource perspective, to respond to market conditions;
- ability to capitalize on opportunities to acquire land on favorable terms; and
- reputation for outstanding service and quality products.

The homebuilding industry is cyclical and is affected by consumer confidence levels, job availability, general economic conditions, and interest rates. Other factors affecting the homebuilding industry and demand for new homes are changes in costs associated with home ownership such as increases in property taxes and

energy costs, changes in consumer preferences, demographic trends, availability of and changes in mortgage financing programs, and the availability and cost of land and building materials. Any slowing in new home sales would increase competition among homebuilders in our market areas. There is no assurance that we will be able to compete successfully against other homebuilders in our current markets in a more competitive business environment resulting from a slowdown in home sales or that such increased competition will not have a material adverse effect on our business and operating results.

### ***Government Regulation and Environmental Matters***

We purchase most of our land with entitlements, providing for zoning and utility services to project sites and giving us the right to obtain building permits. Construction may begin almost immediately upon compliance with specified conditions, which generally are within our control. The time needed to obtain such approvals and permits affects the carrying costs of unimproved property acquired for development and construction. The continued effectiveness of permits already granted is subject to factors such as changes in policies, rules and regulations, and their interpretation and application. To date, the government approval processes discussed above have not had a material adverse effect on our development activities, though there is no assurance that these and other restrictions will not adversely affect future operations.

Local and state governments have broad discretion regarding the imposition of development fees for projects under their jurisdictions. These fees are normally established when we receive recorded maps and building permits. Occasionally, communities impose construction moratoriums. Because most of our land is entitled, construction moratoriums generally would affect us initially if they arose from health, safety, and welfare issues, such as insufficient water, electric or sewage facilities. We could become subject to delays or may be precluded entirely from developing communities due to building moratoriums, “slow growth” initiatives or building permit allocation ordinances, which could be implemented in the future.

We are also subject to a variety of local, state, and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. In some markets, we are subject to environmentally sensitive land ordinances that mandate open space areas with public elements in housing developments, and prevent development on hillsides, wetlands and other protected areas. We must also comply with flood plain restrictions, desert wash areas, native plant regulations, endangered species acts and view restrictions. These and similar laws may result in delays, cause substantial compliance and other costs, and prohibit or severely restrict development in certain environmentally sensitive regions or areas. To date, compliance with such ordinances has not materially affected our operations, though no assurance is given that such a material adverse effect will not occur in the future.

We usually will condition our obligation to purchase property on, among other things, an environmental review of the land. To date, we have not incurred any unanticipated liabilities relating to the removal of unknown toxic wastes or other environmental matters. However, there is no assurance that we will not incur material liabilities in the future relating to toxic waste removal or other environmental matters affecting land currently or previously owned.

### ***Bonds and Other Obligations***

We obtain letters of credit and performance, maintenance, and other bonds in support of our related obligations with respect to the development of our projects. The amount of these obligations outstanding at any time varies in accordance with pending development activities. In the event the bonds or letters are drawn upon, we would be obligated to reimburse the issuer of the bond or letter of credit. At December 31, 2000 there were approximately \$5.7 million in outstanding letters of credit and \$29.1 million in performance bonds for such purposes. We do not believe that any of these bonds or letters of credit are likely to be drawn upon.

### ***Employees and Subcontractors***

At December 31, 2000, we had 360 employees, including 78 in management and administration, 81 in sales and marketing, and 201 in construction operations. Our employees are not unionized, and we believe that employee relations are good. We act solely as a general contractor and all construction operations are conducted through project managers and field superintendents who manage third party subcontractors. We use independent contractors for construction, architectural and advertising services, and believe that our relations with subcontractors and independent contractors are good.

### ***Stock Repurchase Program***

In May 1999, we announced a stock repurchase program in which our Board of Directors approved the buyback of up to \$6 million of outstanding Meritage common stock. The amount was increased to \$20 million in July of 2000. As of December 31, 2000, 811,963 shares had been repurchased for an aggregate price of approximately \$11.0 million.

### **Item 2. Properties**

We lease approximately 12,000 square feet of office space in Scottsdale, Arizona and a 13,000 square foot office in Plano Texas, which serve as our corporate offices. The Scottsdale lease expires in August 2004. The Plano lease expires in May 2002 and the building is leased from a company owned beneficially by one of our Co-Chairmen. Management believes lease rates are competitive with rates for comparable space in the area and terms of the lease are similar to those we could obtain in an arm's length transaction. In addition, we lease approximately 14,300 square feet of space for our operating divisions under leases expiring between October 2001 and July 2005.

We also lease 61 model homes at a total monthly lease amount of \$189,300. The leases are for terms ranging from three months to 36 months, with various renewal options.

### **Item 3. Legal Proceedings**

We are involved in various routine legal proceedings incidental to our business. Management believes that none of these matters, some of which are covered by insurance, will have a material adverse impact upon our financial condition if decided against us.

### **Item 4. Submission of Matters to a Vote of Security Holders**

We did not submit any matters to a vote of shareholders during the fourth quarter of 2000.

## PART II

### Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

#### General

Our common stock is publicly traded on the New York Stock Exchange ("NYSE") under the symbol "MTH". The high and low closing sales prices of the common stock for the periods indicated, as reported by the NYSE, follow:

	<u>High</u>	<u>2000</u>	<u>Low</u>	<u>High</u>	<u>1999</u>	<u>Low</u>
First Quarter	\$ 11.38		\$ 8.88	\$ 15.69		\$ 11.00
Second Quarter	\$ 11.88		\$ 10.00	\$ 13.50		\$ 10.94
Third Quarter	\$ 18.25		\$ 10.69	\$ 13.25		\$ 10.69
Fourth Quarter	\$ 38.06		\$ 18.25	\$ 12.00		\$ 9.94

On March 15, 2001, the closing sales price of the common stock as reported by the NYSE was \$28.90 per share. At that date, there were approximately 290 owners of record. There are approximately 2,500 beneficial owners of common stock.

The transfer agent for our common stock is Mellon Investor Services LLC, 85 Challenger Road, Ridgefield Park, NJ 07660.

We did not declare cash dividends in 2000, 1999 or 1998, nor do we intend to declare cash dividends in the foreseeable future. Earnings will be retained to finance the continuing development of the business. Future cash dividends, if any, will depend upon our financial condition, results of operations and capital requirements, as well as other factors considered relevant by our Board of Directors.

#### Factors That May Affect Future Stock Performance

The performance of our common stock depends upon several factors, including those listed below and in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Factors That May Affect Future Results and Financial Condition."

The market price of our common stock could be subject to significant fluctuations in response to certain factors, such as variations in anticipated or actual results of our operations or that of other homebuilding companies, changes in conditions affecting the general economy, widespread industry trends and analysts' reports, changes in interest rates, as well as other factors unrelated to our operating results.

### Item 6. Selected Financial Data

The following table presents selected historical consolidated financial data for each of the years in the five-year period ended December 31, 2000. The data for all years are derived from our Consolidated Financial Statements audited by KPMG LLP, independent auditors. For additional information, see the Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K. The following table should be read in conjunction with Management's Discussion and Analysis of Financial Condition and the Results of Operations. These historical results may not be indicative of future results.

**Historical Consolidated Financial Data**  
**Years Ended December 31,**  
**(Dollars in thousands, except per share data)**

	<u>2000</u>	<u>1999</u>	<u>1998<sup>(3)</sup></u>	<u>1997<sup>(4)</sup></u>	<u>1996</u>
<b>Income Statement Data:</b>					
Home and land sales revenue	\$ 520,467	\$ 341,786	\$ 257,113	\$ 149,630	N/A
Cost of home and land sales	<u>(415,649)</u>	<u>(277,287)</u>	<u>(205,188)</u>	<u>(124,594)</u>	
Gross profit	104,818	64,499	51,925	25,036	
Earnings from mortgage assets and other income <sup>(6)</sup>	1,847	2,065	5,982	5,435	\$ 2,244
Interest expense	(8)	(6)	(461)	(165)	(238)
Commissions and other sales costs and general and administrative expenses	(49,895)	(34,343)	(24,925)	(15,107)	(1,684)
Minority interest in net income of consolidated joint ventures	---	---	<u>(2,021)</u>	---	---
Earnings before income taxes and extraordinary loss	56,762	32,215	30,500	15,199	322
Income taxes <sup>(1)</sup>	(21,000)	(13,270)	(6,497)	(962)	(26)
Extraordinary loss <sup>(2)</sup>	---	---	---	---	<u>(149)</u>
Net earnings	<u>\$ 35,762</u>	<u>\$ 18,945</u>	<u>\$ 24,003</u>	<u>\$ 14,237</u>	<u>\$ 147</u>
Earnings per diluted share before effect of extraordinary loss	\$ 6.26	\$ 3.14	\$ 3.92	\$ 2.68	\$ .09
Extraordinary loss per diluted share <sup>(2)</sup>	---	---	---	---	<u>(.05)</u>
Diluted earnings per share	<u>\$ 6.26</u>	<u>\$ 3.14</u>	<u>\$ 3.92</u>	<u>\$ 2.68</u>	<u>\$ .04</u>
Cash dividends per share	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ .06</u>
	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996<sup>(5)</sup></u>
<b>Balance Sheet Data:</b>					
Real estate under development	\$ 211,307	\$ 171,012	\$ 104,759	\$ 63,955	\$ 35,991
Residual interests	--	--	--	1,422	3,909
Total assets	267,075	226,559	152,250	96,633	72,821
Notes payable	86,152	85,937	37,205	22,892	30,542
Total liabilities	145,976	136,148	79,971	50,268	45,876
Stockholders' equity	121,099	90,411	72,279	46,365	26,945

- (1) Due to the use of our net operating loss carryforward (NOL), we paid limited income taxes during 1997 and 1998, until the NOL was fully utilized. During 1996 we qualified and elected to be treated as a REIT under federal tax laws and we were not subject to federal income tax on that portion of our taxable income that was distributed to stockholders in or with respect to that year.
- (2) Reflects extraordinary loss from early extinguishment of long-term debt.
- (3) Includes the accounts of Meritage Homes of Northern California from July 1, 1998, the acquisition date.
- (4) Includes the accounts of Legacy Homes from July 1, 1997, the combination date.
- (5) Reflects the merger consummated on December 31, 1996.
- (6) Earnings from mortgage assets is not applicable for 1999 and 2000.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis provides information regarding the results of operations of Meritage Corporation and its subsidiaries for the years ended December 31, 2000, 1999, and 1998. Total results include those of the California operations from July 1, 1998. All material balances and transactions

between Meritage and its subsidiaries have been eliminated. In management's opinion, the data reflects all adjustments, consisting of only normal recurring adjustments, necessary to fairly present our financial position and results of operations for the periods presented.

The results set forth below are not necessarily indicative of those to be expected in the future. In this regard, we expect that our results for 2001 will be affected by a general softening in the economy.

***Home Sales Revenue, Sales Contracts and Net Sales Backlog***

The operating data provided below shows operating and financial data regarding our homebuilding activities.

	<b>Years Ended December 31,</b>		
	<b>(\$ in thousands)</b>		
<b>Home sales revenue</b>	<b><u>2000</u></b>	<b><u>1999</u></b>	<b><u>1998</u></b>
<b><u>Total</u></b>			
Dollars .....	\$ 515,428	\$ 334,007	\$ 255,985
Homes closed.....	2,227	1,643	1,291
Average sales price .....	\$ 231.4	\$ 203.3	\$ 198.3
 <b><u>Texas</u></b>			
Dollars .....	\$ 214,472	\$ 174,850	\$ 130,860
Homes closed.....	1,239	1,135	932
Average sales price .....	\$ 173.1	\$ 154.1	\$ 140.4
 <b><u>Arizona</u></b>			
Dollars .....	\$ 175,674	\$ 120,909	\$ 105,942
Homes closed.....	623	400	317
Average sales price .....	\$ 282.0	\$ 302.3	\$ 334.2
 <b><u>California</u></b>			
Dollars .....	\$ 125,282	\$ 38,248	\$ 19,183
Homes closed.....	365	108	42
Average sales price .....	\$ 343.2	\$ 354.1	\$ 456.7
 <b>Sales Contracts</b>			
<b><u>Total</u></b>			
Dollars .....	\$604,444	\$388,158	\$283,746
Homes ordered.....	2,480	1,840	1,466
Average sales price .....	\$ 243.7	\$ 211.0	\$ 193.6
 <b><u>Texas</u></b>			
Dollars .....	\$240,054	\$191,655	\$166,020
Homes ordered.....	1,368	1,198	1,131
Average sales price .....	\$175.5	\$ 160.0	\$ 146.8
 <b><u>Arizona</u></b>			
Dollars .....	\$196,567	\$127,408	\$115,375
Homes ordered.....	643	436	329
Average sales price .....	\$ 305.7	\$ 292.2	\$ 350.7
 <b><u>California</u></b>			
Dollars .....	\$ 167,823	\$ 69,095	\$ 2,351
Homes ordered.....	469	206	6
Average sales price .....	\$357.8	\$ 335.4	\$ 391.8

<b>Net Sales Backlog</b>	<b>Years Ended December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Total</b>			
Dollars .....	\$309,901	\$199,445	\$145,294
Homes in backlog .....	1,246	885	688
Average sales price .....	\$ 248.7	\$ 225.4	\$ 211.2
<b>Texas</b>			
Dollars .....	\$119,564	\$ 93,983	\$ 77,178
Homes in backlog .....	695	566	503
Average sales price .....	\$ 172.0	\$ 166.0	\$ 153.4
<b>Arizona</b>			
Dollars .....	\$115,211	\$ 72,878	\$ 66,379
Homes in backlog .....	344	216	180
Average sales price .....	\$ 334.9	\$ 337.4	\$ 368.8
<b>California</b>			
Dollars .....	\$ 75,126	\$ 32,584	\$ 1,737
Homes in backlog .....	207	103	5
Average sales price .....	\$ 362.9	\$ 316.3	\$ 347.4

***Year Ended December 31, 2000 Compared to Year Ended December 31, 1999***

**Home Sales Revenue.** Home sales revenue is the product of homes closed during the period and the average sales price per home. The increase in total home sales revenue and number of homes closed in 2000 compared to 1999 results mainly from strong market performance in all of our divisions, as well as the expansion of our operations in Northern California and in our mid-priced Meritage Phoenix division in Arizona. The decreases in average home sales prices in Arizona and Northern California for the year 2000 reflect a change in our product mix, as we are now selling more mid-priced homes than in 1999.

**Sales Contracts.** Sales contracts for any period represent the number of homes ordered by customers (net of homes canceled) multiplied by the average sales price per home ordered. We do not include sales contingent upon the sale of a customer's existing home as a sales contract until the contingency is removed. Historically, we have experienced a cancellation rate approximating 23% of gross sales. Total sales contracts increased in 2000 compared to 1999 due mainly to the expansion of our operations in Northern California and our mid-priced Meritage Phoenix division in Arizona, along with continued economic strength of our operating markets during the year.

**Net Sales Backlog.** Backlog represents net sales contracts that have not closed. Total dollar backlog at December 31, 2000 increased 55% over the 1999 amount due to an increase in the number of homes in backlog and increased sales prices in most of our markets. Homes in backlog at December 31, 2000 increased 41% over the same period in the prior year. These increases resulted from expansion of our operations in Northern California, and in our mid-priced Meritage Phoenix division in Arizona, along with the continued strength of the housing markets in which we operate during the year.

***Year Ended December 31, 1999 Compared to Year Ended December 31, 1998***

**Home Sales Revenue.** The increase in revenue and number of homes closed in 1999 compared to 1998 resulted mainly from the inclusion of the Northern California operations for the full year and continued growth in our Texas and Arizona operations.

**Sales Contracts.** Total sales contracts increased in 1999 compared to 1998 due to the expansion into Northern California, and continued growth in our Texas and Arizona operations.

**Net Sales Backlog.** 1999 total dollar backlog increased 37% over the prior year due to a corresponding increase in homes in backlog. The number of homes in the 1999 backlog increased 29% over the prior year due mainly to the increase in net orders resulting from expansion into Northern California and continued growth in our Texas and Arizona operations. Our backlog also increased somewhat due to extended construction times, which caused longer periods between the time sales contracts were taken and home deliveries were made.

**Other Operating Information**

	Years Ended December 31, (\$ in thousands)		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>Home Sales Gross Profit</b>			
Dollars.....	\$104,225	\$63,810	\$51,576
Percent of home sales revenue.....	20.2%	19.1%	20.1%
<b>Commissions and Other Sales Costs</b>			
Dollars.....	\$28,680	\$19,243	\$14,292
Percent of home sales revenue.....	5.6%	5.8%	5.6%
<b>General and Administrative Costs</b>			
Dollars.....	\$21,215	\$15,100	\$10,632
Percent of total revenue.....	4.1%	4.4%	4.1%
<b>Income Taxes</b>			
Dollars.....	\$21,000	\$13,269	\$6,497
Percent of income before taxes.....	37.0%	41.2%	21.3%

**Year Ended December 31, 2000 Compared to Year Ended December 31, 1999**

**Home Sales Gross Profit.** Gross profit equals home sales revenue, net of housing cost of sales, which include developed lot costs, home construction costs, amortization of common community costs (such as the cost of model complex and architectural, legal and zoning costs), interest, sales tax, warranty, construction overhead and closing costs. The dollar increase in gross profit for the year ended December 31, 2000 is attributable to the increase in number of homes closed and continued growth in all of our markets. The gross profit percentage increase in 2000 resulted from home pricing increases in many of our communities due to a continued strong homebuilding market and due to decreases in some of our material costs resulting from purchasing efficiencies. However, land prices continue to increase, and along with a softening economy, may result in somewhat lower margins in 2001.

**Commissions and Other Sales Costs.** Commissions and other sales costs, such as advertising and sales office expenses, were approximately \$28.7 million, or 5.6% of home sales revenue, in 2000, as compared to approximately \$19.2 million, or 5.8% of home sales revenue in 1999. The decrease in these expenses as a percentage of home sales revenue reflects greater efficiency related to revenue growth.

**General and Administrative Expenses.** General and administrative expenses were approximately \$21.2 million, or 4.1% of total revenue in 2000, as compared to approximately \$15.1 million, or 4.4% of total revenue in 1999. The higher expense as a percentage of revenue in 1999 includes approximately \$600,000 related to the buyout of an employment agreement of a former managing director. Operating costs in 1999 were also higher as a percentage of revenue due to overhead increases incurred related to our California expansion and the start-up of our new Meritage division in Phoenix, Arizona.

**Income Taxes.** The increase in income taxes to \$21.0 million for the year ended December 31, 2000 from \$13.3 million in the prior year resulted from an increase in pre-tax income, partially offset by a slightly lower

effective tax rate. The tax benefit associated with the exercise of employee stock options reduced taxes currently payable by approximately \$1.9 million for the year ended December 31, 2000. This amount was credited to paid in capital.

### ***Year Ended December 31, 1999 Compared to Year Ended December 31, 1998***

***Home Sales Gross Profit.*** The dollar increase in gross profit for the twelve months ended December 31, 1999 is attributable to the increase in number of homes closed due to the inclusion of California operations for the full year, and continued growth in our Texas and Arizona operations. The gross profit percentage decreased in 1999 due to somewhat lower profit margins in our Texas operations and a change in the Arizona housing mix, reflecting a greater proportion of move-up home closings, which typically have lower gross profit margins than our luxury homes.

***Commissions and Other Sales Costs.*** Commissions and other sales costs, such as advertising and sales office expenses, were approximately \$19.2 million, or 5.8% of home sales revenue, in 1999, as compared to approximately \$14.3 million, or 5.6% of home sales revenue in 1998. The slight increase in these expenses as a percentage of home sales revenues was caused to some extent by an increase in the number of new communities that opened for sales in 1999, which resulted in greater start-up expenses.

***General and Administrative Expenses.*** General and administrative expenses were approximately \$15.1 million, or 4.4% of total revenue in 1999, as compared to approximately \$10.6 million, or 4.1% of total revenue in 1998. Operating costs associated with our expansions in Northern California primarily caused this increase.

***Income Taxes.*** The increase in income taxes to \$13.3 million for the year ended December 31, 1999 from \$6.5 million in the prior year resulted from an increase in pre-tax income and a higher effective tax rate. The lower 1998 effective tax rate was caused by utilization of our net operating loss carryforward.

***Earnings From Mortgage Assets and Other Income.*** The overall decline in earnings from mortgage assets and other income in 1999 reflected the sale of our remaining mortgage securities in 1998. Other income includes mortgage company income, which increased in 1999 over 1998.

***Minority Interest.*** The minority interest recorded in 1998 is due to our acquisition of Sterling Communities, which included two 50% owned limited partnership interests which Meritage controlled. We recorded the minority interest partners' share of net income as an expense. The limited partnerships' operations were concluded in the fourth quarter of 1998.

### ***Liquidity and Capital Resources***

Our principal uses of working capital are land purchases, lot development and home construction. We use a combination of borrowings and funds generated by operations to meet our working capital requirements.

Cash flow for each of our communities depends on the status of the development cycle, and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, plat and other approvals, and construction of model homes, roads, certain utilities, general landscaping and other amenities. Because these costs are capitalized, income reported for financial statement purposes during those early stages may significantly exceed cash flow. Later, cash flow can significantly exceed earnings reported for financial statement purposes, as cost of sales includes charges for substantial amounts of previously expended costs.

At December 31, 2000 we had short-term secured revolving construction loans and acquisition and development facilities totaling \$170.7 million of which approximately \$71 million was outstanding. An additional \$53.5 million of unborrowed funds supported by approved collateral were available under our credit facilities at that date. Borrowings under the credit facilities are subject to our inventory collateral position and a number of other conditions, including minimum net worth, debt to equity and debt coverage compliance requirements. We also have \$15 million outstanding in unsecured, senior subordinated notes due September 15, 2005, which were issued in October 1998.

Management believes that the current borrowing capacity, cash on hand at December 31, 2000 and anticipated cash flows from operations are sufficient to meet liquidity needs for the foreseeable future. There is no assurance, however, that future cash flows will be sufficient to meet future capital needs. The amount and types of indebtedness that we incur may be limited by the terms of the indenture governing our senior subordinated notes and credit agreements.

### ***Seasonality***

We historically have closed more homes in the second half of the fiscal year than in the first half, due in part to the slightly seasonal nature of the market for our semi-custom luxury and move-up products. Management expects this seasonal trend to continue, though it may vary as operations continue to expand.

### ***New Accounting Standards***

In June 1998 the Financial Accounting Standards Board (“FASB”) issued SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” which established standards for the accounting and reporting for all derivative instruments and hedging activities. This statement requires that all derivatives are recognized as assets or liabilities in the balance sheet and measured at fair value, and that recognition of gains and losses are required on hedging instruments based on changes in fair value or the earnings effect of forecasted transactions. This new standard, as amended by SFAS No. 137 and No. 138, is effective beginning January 1, 2001. This pronouncement will not have a material impact on our consolidated financial statements.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements,” (SAB No. 101) which summarizes the SEC staff’s views in applying accounting principles generally accepted in the United States of America to revenue recognition in financial statements. SAB No. 101 was amended by SAB No. 101A and No. 101B in March and June, 2000, respectively, to delay the implementations date of SAB No. 101 until no later than the fourth fiscal quarter of fiscal years beginning after December 16, 1999. We have adopted the provisions of SAB No. 101 and the adoption did not have a material effect on the consolidated financial statements.

In March 2000, the FASB issued Interpretation No. 44, “Accounting for Certain Transactions Involving Stock Compensation – An Interpretation of APB Opinion No. 25.” The Interpretation clarifies the application of APB Opinion No. 25 in certain situations, as defined. The Interpretation was effective July 1, 2000, but covers certain events having occurred after December 15, 1998. We have adopted this Interpretation and the adoption did not have a material impact on our consolidated financial statements.

## **Factors That May Affect Our Future Results and Financial Condition**

Future operating results and financial condition depend on our ability to successfully design, develop, construct and sell homes that satisfy dynamic customer demand patterns. Inherent in this process are factors that we must successfully manage to achieve favorable future operating results and financial condition. These operating and financial conditions, along with many other factors, could affect the price of our common stock. Potential risks and uncertainties that could affect future operating results and financial condition could include the factors discussed below.

*Homebuilding Industry Factors.* The homebuilding industry is cyclical and is significantly affected by changes in economic and other conditions, such as employment levels, availability of financing, interest rates, and consumer confidence. Although management believes that many of our customers (particularly purchasers of luxury and move-up homes) tend to be less price-sensitive than generally is the case for other homebuilders, such uncertainties could adversely affect our performance. Homebuilders are also subject to various risks, many of which are outside their control, including delays in construction schedules, cost overruns, changes in governmental regulations, increases in real estate taxes and other local government fees, and availability and cost of land, materials, and labor. Although the principal raw materials used in the homebuilding industry generally are available from a variety of sources, the materials are subject to periodic price fluctuations. There is no assurance that the occurrence or continuation of any of the above items will not have a material adverse effect on our business.

The homebuilding industry is subject to the potential for significant variability and fluctuations in real estate values, as evidenced by the changes in real estate prices in recent years in Texas, Arizona and Northern California. Although we believe that our projects are currently reflected on our balance sheet at appropriate values, there is no assurance that write-downs of some or all of our projects will not occur if market conditions deteriorate, or that such write-downs will not be material in amount.

*Fluctuations in Operating Results.* We historically have experienced, and expect to continue to experience, variability in home sales and net earnings on a quarterly basis. As a result of such variability, our historical performance may not be a meaningful indicator of future results. Factors that contribute to this variability include:

- timing of home deliveries and land sales;
- the ability to continue the acquisition of additional land or options to acquire additional land on acceptable terms;
- conditions of the real estate market in areas where we operate and the general economy;
- the cyclical nature of the homebuilding industry, changes in prevailing interest rates and the availability of mortgage financing;
- costs or shortages of materials and labor; and
- delays in construction schedules due to strikes, adverse weather, acts of God, and the availability of subcontractors or governmental restrictions.

*Interest Rates and Mortgage Financing.* We believe that many of our move-up and luxury home customers have been less sensitive to interest rate fluctuations than other homebuyers. However, most of our buyers finance their home purchase through third-party lenders providing mortgage financing. In general, housing demand is adversely affected by increases in interest rates and housing costs, and the unavailability of mortgage financing. If mortgage interest rates increase and the ability of prospective buyers to finance home purchases is consequently affected adversely, home sales, gross margins and net income may also be adversely impacted and the impact may be material. Our homebuilding activities depend upon the availability and costs of mortgage financing for buyers of homes owned by potential customers so those customers (“move-up buyers”) can sell their homes and purchase a Meritage home. Any limitations or restrictions of financing availability could adversely affect home sales. Changes in federal income tax laws may also affect demand for new homes. Various proposals have been publicly discussed to limit mortgage interest deductions and to eliminate or limit tax-free rollover treatment provided under current law where the proceeds of the sale of a principal residence are reinvested in a new principal residence. Enactment of such proposals may have an adverse effect on the homebuilding industry in general, and on demand for our products in particular. No prediction can be made whether any such proposals will be enacted and, if enacted, the particular form such laws would take.

*Inflation.* Meritage, as well as other homebuilders, may be adversely affected during periods of high inflation, mainly because of higher land and construction costs. Also, higher mortgage interest rates may significantly affect the affordability of permanent mortgage financing to prospective buyers. Inflation also increases our cost of financing, materials and labor. We attempt to pass cost increases on to our customers through higher sales prices. To date, inflation has not had a material adverse effect on our results of

operations; however, there is no assurance that inflation will not have a material adverse effect on our future operating results.

*Competition.* The single-family residential housing industry is highly competitive. Homebuilders vie for desirable properties, financing, raw materials, and skilled labor. We also compete for residential home sales with other developers and individual resales of existing homes. Competitors include large homebuilding organizations, some of which have greater financial resources than the Company, and smaller homebuilders, which may have lower costs. Competition is expected to continue and become more intense, and there may be new entrants in the markets in which we currently operate and in markets we may enter in the future.

*Lack of Geographic Diversification.* We have operations in Texas, Arizona and Northern California. Failure to be more geographically diversified could have an adverse effect on the Company if the homebuilding business in our current markets should decline, since there may not be a balancing opportunity in a stronger market in other geographic regions.

*Additional Financing; Limitations.* The homebuilding industry is capital intensive and requires significant up-front expenditures to acquire land and begin development. Accordingly, we incur substantial indebtedness to finance our homebuilding activities. At December 31, 2000, our debt totaled approximately \$86.2 million. We may be required to seek additional capital in the form of equity or debt financing from a variety of potential sources, including bank financing and securities offerings. Also, lenders are increasingly requiring developers to invest significant amounts of equity in a project both in connection with origination of new loans as well as the extension of existing loans. If we cannot obtain sufficient capital to fund our planned capital or other expenditures, new projects may be delayed or abandoned, which could result in a reduction in home sales and may adversely affect operating results. There is no assurance that additional debt or equity financing will be available in the future or on acceptable terms.

The terms and conditions of our current indebtedness limit the amount and types of indebtedness that we can incur. We must comply with numerous operating and financial maintenance covenants and there is no assurance that we will be able to maintain compliance with these financial and other covenants. Failure to comply with the covenants would result in default and resulting cross defaults under our other indebtedness, and could induce acceleration of all indebtedness, which would have a material adverse affect on the Company.

*Government Regulations; Environmental Conditions.* We are subject to local, state, and federal statutes and rules regulating certain developmental matters, as well as building and site design. We are subject to various fees and charges of governmental authorities designed to defray the cost of providing certain governmental services and improvements. We may be subject to additional costs and delays or may be precluded entirely from building projects because of “no growth” or “slow growth” initiatives, building permit ordinances, building moratoriums, or similar government regulations that could be imposed in the future due to health, safety, welfare, or environmental concerns. We must also obtain licenses, permits, and approvals from government agencies to engage in certain activities, the granting or receipt of which are beyond our control.

Meritage and its competitors are also subject to a variety of local, state, and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. Environmental laws or permit restrictions may result in project delays, may cause substantial compliance and other costs and may prohibit or severely restrict development in certain environmentally sensitive regions or geographic areas. Environmental regulations can also have an adverse impact on the availability and price of certain raw materials such as lumber.

*Recent and Future Expansion.* We may continue to consider growth or expansion of our operations in our current markets in other areas of the country. The magnitude, timing and nature of any future expansion will depend on a number of factors, including suitable acquisition candidates, the negotiation of acceptable terms, our financial capabilities, and general economic and business conditions. New acquisitions may result in the incurrence of additional debt and/or amortization of expenses related to goodwill and intangible assets that

could adversely affect our profitability, or result in potentially dilutive issuances of equity securities. Acquisitions also involve numerous risks, including difficulties in the assimilation of the acquired company's operations, the diversion of management's attention from other business concerns, risks of entering markets in which we have had limited or no direct experience and the potential loss of key employees of the acquired company. There can be no assurance that we will be able to expand into new or existing markets on a profitable basis.

*Dependence on Key Personnel.* Our success is largely dependent on the continuing services of certain key employees, and the ability to attract new personnel required for our favorable development. Although we have entered into employment agreements with various key officers, loss of their services could have a material adverse affect on our business.

*Dependence on Subcontractors.* We conduct our business only as a general contractor in connection with the design, development and construction of our communities. Virtually all architectural and construction work is performed by subcontractors. As a consequence, we are dependent upon the continued availability and satisfactory performance by unaffiliated third parties for the design and construction of our homes. There is no assurance that there will be sufficient availability and satisfactory performance by unaffiliated third-party subcontractors. Inadequate subcontractor resources could have a material adverse affect on our business.

### **Special Note of Caution Regarding Forward-Looking Statements**

In passing the Private Securities Litigation Reform Act of 1995 (the "PLSRA") Congress encouraged public companies to make "forward looking statements" by creating a safe harbor to protect companies from securities law liability in connection with forward-looking statements. Meritage intends to qualify both its written and oral forward-looking statements for protection under the PLSRA.

In general, "forward-looking statements" can be identified by use of words such as "expect," "believe," "estimate," "project," "forecast," "anticipate," "plan" and similar expressions. In this report, forward looking statements address such matters but are not limited to, projections of revenues, income or loss, capital expenditures, plans for future operations, financing needs, the impact of changes in interest rates, plans relating to our new products or services, potential real property acquisition, and new or planned development projects, as well as assumptions related to the foregoing. Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, those factors described above under the caption "Factors That May Affect Our Future Results and Financial Condition" and other statements in this Form 10-K, including the Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-looking statements express expectations of future events. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events and they are subject to numerous known and unknown risks and uncertainties would could cause actual events or results to differ materially from those projected. Due to these inherent uncertainties, the investment community is urged not to place undue reliance on forward looking statements. In addition, Meritage undertakes no obligations to update or revise forward-looking statements to reflect changed assumptions, the occurrence of anticipated events or changes to projections over time.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Meritage does not enter into financial instruments for trading purposes, though we do have other financial instruments in the form of notes payable and senior debt. Our lines of credit and credit facilities are at variable interest rates and are subject to market risk in the form of interest rate fluctuations. The interest rate on our senior debt is at a fixed rate.

For example, based on our average bank borrowings of \$81.1 million during 2000, if the interest rate indices on which our bank borrowing rates are based were to increase 100 basis points in 2001, interest incurred would increase and cash flows would decrease in 2001 by \$811,000. A portion of the increased interest would be expensed as a period cost in 2001, while the balance would be capitalized to real estate under development and be expensed as a cost of home sales in 2001 and future years.

## **Item 8. Financial Statements and Supplementary Data**

Our Consolidated Financial Statements as of December 31, 2000 and 1999 and for each of the years in the three-year period ended December 31, 2000, together with related notes and the report of KPMG LLP, independent auditors, are on the following pages. Other required financial information is more fully described in Item 14.

## REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders  
Meritage Corporation

We have audited the accompanying consolidated balance sheets of Meritage Corporation and subsidiaries (the Company) as of December 31, 2000 and 1999 and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly in all material respects, the financial position of Meritage Corporation and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Phoenix, Arizona  
February 8, 2001

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<u>December 31,</u>	
	<u>2000</u>	<u>1999</u>
	(In thousands, except share data)	
<b>Assets</b>		
Cash and cash equivalents	\$ 4,397	\$ 13,422
Real estate under development	211,307	171,012
Deposits on real estate under option or contract	24,251	15,700
Other receivables	2,179	1,643
Deferred tax asset	543	699
Goodwill	17,675	18,742
Property and equipment, net	4,717	4,040
Other assets	<u>2,006</u>	<u>1,301</u>
 Total Assets	 <u>\$ 267,075</u>	 <u>\$ 226,559</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	\$ 48,907	\$ 41,951
Home sale deposits	10,917	8,261
Notes payable	<u>86,152</u>	<u>85,936</u>
 Total Liabilities	 <u>145,976</u>	 <u>136,148</u>
<b>Stockholders' Equity</b>		
Common stock, \$.01 par value, 50,000,000 shares authorized, 5,922,822 shares at December 31, 2000 and 5,474,906 shares at December 31, 1999, issued and outstanding	59	55
Additional paid-in capital	102,526	100,407
Retained earnings (accumulated deficit)	29,530	(8,149)
Treasury stock at cost, 811,963 and 186,000 shares at December 31, 2000 and 1999, respectively	<u>(11,016)</u>	<u>(1,902)</u>
 Total Stockholders' Equity	 <u>121,099</u>	 <u>90,411</u>
 Total Liabilities and Stockholders' Equity	 <u>\$ 267,075</u>	 <u>\$ 226,559</u>

See accompanying notes to consolidated financial statements

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF EARNINGS**

	<u>Years Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(In thousands, except per share data)		
Home sales revenue	\$ 515,428	\$ 334,007	\$ 255,985
Land sales revenue	<u>5,039</u>	<u>7,779</u>	<u>1,128</u>
	520,467	341,786	257,113
Cost of home sales	(411,203)	(270,197)	(204,409)
Cost of land sales	<u>(4,446)</u>	<u>(7,090)</u>	<u>(779)</u>
	(415,649)	(277,287)	(205,188)
Home sales gross profit	104,225	63,810	51,576
Land sales gross profit	<u>593</u>	<u>689</u>	<u>349</u>
	104,818	64,499	51,925
Commissions and other sales costs	(28,680)	(19,243)	(14,292)
General and administrative expenses	(21,215)	(15,100)	(10,632)
Interest expense	(8)	(6)	(462)
Other income, net	1,847	2,064	751
Earnings from mortgage assets	---	---	5,231
Minority interest in net income of consolidated joint ventures	<u>---</u>	<u>---</u>	<u>(2,021)</u>
Earnings before income taxes	56,762	32,215	30,500
Income taxes	<u>(21,000)</u>	<u>(13,269)</u>	<u>(6,497)</u>
Net earnings	<u>\$ 35,762</u>	<u>\$ 18,945</u>	<u>\$ 24,003</u>
Basic earnings per share	<u>\$ 6.92</u>	<u>\$ 3.49</u>	<u>\$ 4.51</u>
Diluted earnings per share	<u>\$ 6.26</u>	<u>\$ 3.14</u>	<u>\$ 3.92</u>

See accompanying notes to consolidated financial statements

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Years Ended December 31, 2000, 1999 and 1998  
(In thousands)

	<u>Number of Shares</u>	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings/ (Accumulated Deficit)</u>	<u>Treasury Stock</u>	<u>Total</u>
Balance at December 31, 1997 .....	5,255	\$ 53	\$ 97,819	\$ (51,097)	\$ (410)	\$ 46,365
Net earnings .....	---	---	---	24,003	---	24,003
Exercise of stock options .....	44	---	514	---	---	514
Contingent and warrant shares issued .....	89	1	(1)	---	---	---
Stock option and contingent stock compensation expenses .....	---	---	1,398	---	---	1,398
Retirement of treasury stock .....	(53)	(1)	(410)	---	410	(1)
Balance at December 31, 1998 .....	5,335	53	99,320	(27,094)	---	72,279
Net earnings .....	---	---	---	18,945	---	18,945
Exercise of stock options .....	51	1	495	---	---	496
Contingent shares issued .....	89	1	(1)	---	---	---
Stock option and contingent stock compensation expenses .....	---	---	593	---	---	593
Purchase of treasury stock .....	---	---	---	---	(1,902)	(1,902)
Balance at December 31, 1999 .....	5,475	55	100,407	(8,149)	(1,902)	90,411
Net earnings .....	---	---	---	35,762	---	35,762
Tax benefit from stock option exercise .....	---	---	---	1,917	---	1,917
Exercise of stock options .....	359	3	2,047	---	---	2,050
Contingent shares issued .....	89	1	(1)	---	---	---
Stock option and contingent stock compensation expenses .....	---	---	73	---	---	73
Purchase of treasury stock .....	---	---	---	---	(9,114)	(9,114)
Balance at December 31, 2000 .....	<u>5,923</u>	<u>\$ 59</u>	<u>\$ 102,526</u>	<u>\$ 29,530</u>	<u>\$ (11,016)</u>	<u>\$ 121,099</u>

See accompanying notes to consolidated financial statements

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(In thousands)		
<b>Cash flows from operating activities:</b>			
Net earnings .....	\$ 35,762	\$ 18,945	\$ 24,003
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization.....	3,407	2,528	1,637
Minority interest in net income of consolidated joint ventures .....	---	---	2,021
Deferred tax expense .....	156	6,236	4,969
Tax benefit from stock option exercise .....	1,917	---	---
Stock option compensation expense.....	73	593	1,398
Gain on sales of residual interests .....	---	---	(5,180)
Increase in real estate under development .....	(40,295)	(66,254)	(32,046)
Increase in deposits on real estate under option or contract .....	(8,551)	(8,361)	(3,578)
(Increase) decrease in other receivables and other assets .....	(1,241)	680	(1,775)
Increase in accounts payable and accrued liabilities .....	12,368	9,571	4,375
Increase (decrease) in home sale deposits .....	<u>2,656</u>	<u>(326)</u>	<u>1,810</u>
Net cash provided by (used in) operating activities .....	<u>6,252</u>	<u>(36,387)</u>	<u>(2,366)</u>
<b>Cash flows from investing activities:</b>			
Cash acquired in merger/acquisition .....	---	---	785
Cash paid for merger/acquisition .....	(5,158)	(6,967)	(9,744)
Purchases of property and equipment.....	(3,017)	(2,935)	(1,569)
Proceeds from sales of residual interest.....	---	---	<u>6,600</u>
Net cash used in investing activities .....	<u>(8,175)</u>	<u>(9,902)</u>	<u>(3,928)</u>
<b>Cash flows from financing activities:</b>			
Borrowings .....	447,269	273,824	174,446
Repayment of borrowings.....	(447,054)	(225,093)	(164,524)
Purchase of treasury shares.....	(9,114)	(1,902)	---
Stock options exercised .....	<u>1,797</u>	<u>495</u>	<u>514</u>
Net cash (used in) provided by financing activities .....	<u>(7,102)</u>	<u>47,324</u>	<u>10,436</u>
Net (decrease) increase in cash and cash equivalents.....	(9,025)	1,035	4,142
Cash and cash equivalents at beginning of year .....	<u>13,422</u>	<u>12,387</u>	<u>8,245</u>
Cash and cash equivalents at end of year .....	<u>\$ 4,397</u>	<u>\$ 13,422</u>	<u>\$ 12,387</u>
Supplemental information:			
Cash paid for interest.....	\$ 8,403	\$ 5,873	\$ 3,997
Cash paid for income taxes.....	\$ 18,786	\$ 5,423	\$ 2,333

See accompanying notes to consolidated financial statements

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2000, 1999 and 1998**

**NOTE 1 – ORGANIZATION AND BASIS OF PRESENTATION**

**Business.** Meritage Corporation develops, constructs and sells new high quality, single-family homes in the semi-custom luxury, move-up and entry-level markets.

We were formed in 1988 as a real estate investment trust (“REIT”) that invested in mortgage-related assets and real estate loans. On December 31, 1996, the Company acquired by merger the homebuilding operations of various entities operating under the Monterey Homes name, and has phased out the mortgage-related operations. Monterey has been building homes in Arizona for over 15 years, specializing in move-up and semi-custom luxury homes.

As part of our strategy to diversify operations, on July 1, 1997, we combined with Legacy Homes, a group of entities with homebuilding operations in Texas. Legacy has been in business since 1988, and designs, builds and sells entry-level and move-up homes. On July 1, 1998 we acquired Sterling Communities, now Meritage Homes of Northern California, which has homebuilding operations in the San Francisco Bay and Sacramento metropolitan areas, and targets move-up homebuyers. In September 1998, with shareholder approval, Meritage Corporation became our new corporate name.

**Basis of Presentation.** The consolidated financial statements include the accounts of Meritage Corporation and its subsidiaries (“Meritage” or “the Company”). Intercompany balances and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to be consistent with current period financial statement presentation. Financial results include the operations of Meritage Homes of Northern California from July 1, 1998.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Cash and Cash Equivalents.** We consider short-term investments in liquid debt instruments with an initial maturity of three months or less to be cash equivalents. Amounts in transit from title companies for home closings of approximately \$5.5 million and \$1.6 million are included in cash at December 31, 2000 and 1999, respectively.

**Real Estate Under Development.** Real estate under development consists of raw land, lots under development, homes under construction and completed homes. This inventory is carried at cost unless such costs would not be recovered from the cash flows generated by future disposition. In this case, amounts are carried at estimated fair value less disposal costs. Costs capitalized include direct construction costs for homes, development period interest and certain common costs that benefit the entire community. Common costs are allocated on a community-by-community basis to residential lots based on the number of lots to be built in the community, which approximates the relative sales value method.

Deposits paid related to land options and contracts to purchase land are capitalized when incurred and classified as deposits on real estate under option or contract until the related land is purchased. The deposits are then transferred to real estate under development.

**Cost of Home Sales.** Cost of home sales includes land acquisition and development costs, direct home construction costs, development period interest and closing costs and an allocation of common costs.

**Revenue Recognition and Classification of Costs.** Revenues and profits from sales of residential real estate and related activities are recognized when closings have occurred, the buyer has made a minimum down payment and other criteria for sale and profit recognition are satisfied.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Estimated future warranty costs are charged to cost of sales in the period when the revenues from the related home closings are recognized. These estimated warranty costs generally range from .3% to .75% of the home's sales price. To date, the reserve has been sufficient to cover warranty costs incurred.

**Property and Equipment.** Property and equipment is stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Accumulated depreciation was approximately \$5.4 million and \$3.5 million at December 31, 2000 and 1999, respectively. Maintenance and repair costs are expensed as incurred.

**Goodwill.** Goodwill represents the excess of purchase price over fair value of net assets acquired and is being amortized on a straight-line basis over a 20-year period. Accumulated amortization was approximately \$2.8 million at December 31, 2000 and \$1.8 million at December 31, 1999. Management periodically evaluates the businesses to which the goodwill relates to determine if the carrying value of goodwill has been impaired. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting our average cost of funds. No goodwill impairment was recorded in the accompanying statements of earnings.

**Residual Interests.** During 1998, we owned residual interests in collateralized mortgage obligations (CMOs) and in mortgage participation certificates (MPCs) (collectively residual interests). We used the prospective net level yield method, in which interest is recorded at cost and amortized over the life of the related CMO or MPC issuance, to account for the residual interests. During 1998 we sold our remaining residual interests for a gain and generated interest income from these assets prior to sale totaling approximately \$5.2 million.

**Income Taxes.** We account for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes". Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in future years and are subsequently adjusted for changes in the rates. The effect on deferred tax assets and liabilities of a change in tax rates is a charge or credit to deferred tax expense in the period of enactment.

**Earnings Per Share.** We compute basic earnings per share by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings.

**Use of Estimates.** The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions relating to amounts reported in the financial statements and accompanying notes. Actual results could differ materially from these estimates.

**Fair Value of Financial Instruments.** The carrying amounts of our short-term financial instruments are reasonable approximations of fair value. Our notes payable carry interest rates that are variable and/or comparable to current market rates based on the nature of the loans, their terms and remaining maturity, and therefore are stated at approximate fair value. Considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, these fair value estimates are subjective and not necessarily indicative of the amounts we would pay or receive in actual market transactions.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**Stock Option Plans.** We have elected to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25 as allowed by SFAS No. 123 "Accounting for Stock-Based Compensation". As such, compensation expense would be recorded on the date of the grant only if the market price of the stock underlying the grant was greater than the exercise price. The pro forma disclosures that are required by SFAS No. 123 are presented in Note 6.

**Segment Information.** Statement of Financial Accounting Standards No. 131, "Disclosures about Segments for an Enterprise and Related Information" was issued in June 1997. SFAS No. 131 establishes standards for the way that public companies report selected information about operating segments in financial reports issued to stockholders. We have adopted the provisions of SFAS No. 131, which caused no significant impact on our definitions of our operating segments and related disclosures.

**NOTE 3 - REAL ESTATE UNDER DEVELOPMENT AND CAPITALIZED INTEREST**

Real estate under development at December 31 includes (in thousands):

	<u>2000</u>	<u>1999</u>
Homes under contract, in production	\$ 92,881	\$ 71,987
Finished lots and lots under development	88,266	63,610
Model homes and homes held for resale	26,937	31,797
Land held for development	<u>3,223</u>	<u>3,618</u>
	<u>\$ 211,307</u>	<u>\$ 171,012</u>

We capitalize certain interest costs incurred during development and construction. Capitalized interest is allocated to real estate under development and charged to cost of home sales when the property is delivered. Summaries of interest capitalized and interest expensed follow (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2000</u>	<u>1999</u>
Beginning unamortized capitalized interest	\$ 3,971	\$ 1,982
Interest capitalized	10,626	7,025
Amortization to cost of home sales	<u>(9,171)</u>	<u>(5,036)</u>
Ending unamortized capitalized interest	<u>\$ 5,426</u>	<u>\$ 3,971</u>
Interest incurred	\$ 10,634	\$ 7,031
Interest capitalized	<u>(10,626)</u>	<u>(7,025)</u>
Interest expense	<u>\$ 8</u>	<u>\$ 6</u>

Under option contracts with specific performance, purchase of the properties is dependent upon the completion of certain requirements by us and the sellers. At December 31, 2000, we had approximately 785 lots with an aggregate purchase price of approximately \$24.5 million under option contracts with specific performance.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**NOTE 4 – NOTES PAYABLE**

Notes payable at December 31 consists of the following (in thousands):

	<u>2000</u>	<u>1999</u>
\$100 million bank revolving construction line of credit, interest payable monthly approximating prime (9.5% at December 31, 2000) or LIBOR plus 1.75% (at rates ranging from 8.320% to 8.553% at December 31, 2000) payable at the earlier of close of escrow, maturity date of individual homes within line or over a 24 month period beginning on January 1, 2002, secured by first deeds of trust on real estate	\$ 50,354	\$ 37,411
\$65 million bank revolving construction line of credit, interest payable monthly approximating prime or LIBOR (30 day LIBOR 6.565% at December 31, 2000) plus 2.0%, payable at the earlier of close of escrow, maturity date of individual homes within the line or July 31, 2001, secured by first deeds of trust on real estate	17,269	26,104
\$15 million unsecured bank revolving line of credit, interest payable monthly at prime, matured January 17, 2000	--	6,000
Acquisition and development credit facilities and seller carry back financing totaling \$5.7 million, interest payable monthly, ranging from prime to prime plus .25% or at a fixed 10% per annum rate; payable at the earlier of funding of construction financing or the maturity date of the individual projects, secured by first deeds of trust on real estate	3,516	1,396
Senior unsecured notes, maturing September 15, 2005, annual interest of 9.1% payable quarterly, principal payable in three equal installments on September 15, 2003, 2004 and 2005	15,000	15,000
Other	<u>13</u>	<u>26</u>
Total	<u>\$ 86,152</u>	<u>\$ 85,937</u>

The bank credit facilities and senior unsecured notes contain covenants which require certain levels of tangible net worth, the maintenance of certain minimum financial ratios, place limitations on the payment of dividends and limit incurrence of indebtedness, asset dispositions and creations of liens, among other items. As of December 31, 2000 and throughout the year, we were in compliance with these covenants.

On October 2, 1998, we issued \$15 million in 9.1% Senior Unsecured Notes due September 1, 2005 in a private placement to accredited investors under Section 4(2) of the Securities Act of 1934. Placement agents for this issue were paid a fee of 2.75% of the face amounts of the notes. The notes were sold at par to four entities controlled by Massachusetts Mutual Life Insurance Company. The proceeds of the issue were used to pay down existing indebtedness.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Scheduled maturities of notes payable as of December 31, 2000 follow (in thousands):

<b>Years Ended December 31,</b>	
2001.....	\$ 19,586
2002.....	50,354
2003.....	6,212
2004.....	5,000
2005.....	5,000
Thereafter.....	<u>    --</u>
	<u>\$ 86,152</u>

**NOTE 5 - EARNINGS PER SHARE**

A summary of the reconciliation from basic earnings per share to diluted earnings per share for the years ended December 31, follows (in thousands, except per share amounts):

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Net earnings	\$ 35,762	\$ 18,945	\$ 24,003
Basic EPS – Weighted average shares outstanding	<u>5,171</u>	<u>5,431</u>	<u>5,317</u>
Basic earnings per share	<u>\$ 6.92</u>	<u>\$ 3.49</u>	<u>\$ 4.51</u>
Basic EPS – Weighted average shares outstanding	5,171	5,431	5,317
Effect of dilutive securities:			
Contingent shares and warrants	19	89	158
Stock options	<u>524</u>	<u>512</u>	<u>641</u>
Dilutive EPS – Weighted average shares outstanding	<u>5,714</u>	<u>6,032</u>	<u>6,116</u>
Diluted earnings per share	<u>\$ 6.26</u>	<u>\$ 3.14</u>	<u>\$ 3.92</u>
Antidilutive stock options not included in diluted EPS	<u>38</u>	<u>279</u>	<u>59</u>

**NOTE 6 – STOCK OPTIONS**

Our Board of Directors administers our stock option plan. The plan provides for stock option grants to key personnel and directors, and provide a means of performance-based compensation in order to attract and retain qualified employees.

We apply APB Opinion No. 25 and related interpretations in accounting for our plan. Under APB 25, if the exercise price of the Company's stock options is equal to the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Had compensation cost for these plans been determined consistent with SFAS No. 123, our net earnings and earnings per share would have been reduced to the following pro forma amounts (in thousands, except for per share amounts):

		<u>2000</u>	<u>1999</u>	<u>1998</u>
Net earnings .....	As reported	\$ 35,762	\$ 18,945	\$ 24,003
	Pro forma	35,464	18,472	23,573
Basic earnings per share .....	As reported	6.92	3.49	4.51
	Pro forma	6.86	3.40	4.43
Diluted earnings per share .....	As reported	6.26	3.14	3.92
	Pro forma	6.21	3.06	3.85

The per share weighted average fair values of stock options granted during 2000, 1999 and 1998 were \$5.67, \$7.81 and \$9.91, respectively, on the dates of grant using the Black-Scholes pricing model based on the following weighted average assumptions:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Expected dividend yield .....	0%	0%	.5%
Risk-free interest rate.....	6.71%	4.76%	5.75%
Expected volatility .....	47%	52%	51%
Expected life (in years).....	6	6	7

***The Meritage Plan***

Meritage shareholders approved our current stock option plan at the 1997 Annual Shareholders Meeting. The plan authorizes grants of incentive stock options and non-qualified stock options to our executives, directors, employees and consultants. A total of 742,700 shares of Meritage common stock are reserved for issuance upon exercise of stock options granted under this plan. The options vest over periods from two to five years, are based on continued employment, and expire five to ten years after the date of grant.

***The Prior Plan***

The 1988 Homeplex Mortgage Investments Corporation Stock Option Plan (the prior plan) was in effect at the time of the merger. No new grants were issued under this plan since the merger, and all remaining options were exercised during December 31, 2000.

***Other Options***

In connection with the merger and Legacy combination, Mssrs. Hilton, Landon and Cleverly each received 166,667 non-qualified stock options that vest over three years. The exercise price of the options is \$5.25 per share, which was negotiated at the time of the transactions. Mr. Hilton's and Mr. Cleverly's options expire in December 2002 and Mr. Landon's expire in June 2001.

An ex-member of our board of directors who served as our president and chairman prior to the merger held 250,000 non-qualified stock options. The options were granted in exchange for the director forgoing his annual salary and bonus, and were approved by shareholders at the 1996 Annual Meeting. These options were exercised in 2000 at an exercise price of \$ 4.50 per share.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

*Summary of stock option activity:*

	2000		1999		1998	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding at beginning of year	1,173,226	\$ 7.65	1,028,302	\$ 6.25	1,041,480	\$ 5.86
Options granted	89,800	10.43	264,500	14.74	57,500	16.54
Options exercised	(359,026)	5.00	(51,076)	7.08	(43,660)	10.04
Options canceled	(10,000)	12.17	(68,500)	14.39	(27,018)	7.22
Options outstanding at end of year	894,000	\$ 8.73	1,173,226	\$ 7.65	1,028,302	\$ 6.25
Options exercisable at end of year	587,700		801,669		613,579	
Price range of options exercised	\$4.37 - \$14.25		\$5.62 - \$11.25		\$4.50 - \$11.25	
Price range of options outstanding	\$5.25 - \$18.00		\$4.50 - \$17.63		\$4.50 - \$17.63	
Total shares reserved at end of year	1,226,571		1,386,583		1,525,547	

*Stock options outstanding at December 31, 2000 were:*

	Options Outstanding			Options Exercisable	
	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
<u>Range of Exercise Prices</u>					
\$ 5.25 - \$ 5.62	502,500	2.4 years	\$ 5.27	489,500	\$ 5.26
\$ 8.50 - \$13.37	145,000	6.0	9.81	36,000	9.15
\$14.25 - \$18.00	246,500	1.3	15.13	62,200	15.32
	894,000	3.7 years	\$ 8.73	587,700	\$ 6.57

**NOTE 7 - COMMITMENTS AND CONTINGENCIES**

We are involved in legal proceedings and claims that arise in the ordinary course of business. Management believes the amount of ultimate liability, if any, with respect to these actions will not have a material adverse effect on our financial position.

In the normal course of business, we provide standby letters of credit and performance bonds issued to third parties to secure performance under various contracts. At December 31, 2000 outstanding letters of credit were \$5.7 million and performance bonds were \$29.1 million.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

We lease office facilities, model homes and equipment under various operating lease agreements. Approximate future minimum lease payments for noncancellable operating leases as of December 31, 2000 are as follows (in thousands):

<b>Years Ending December 31,</b>	
2001 .....	\$ 1,940
2002.....	795
2003.....	478
2004.....	391
2005.....	107
Thereafter .....	<u>    -</u>
	<u>\$ 3,711</u>

Rental expense approximated \$1.6 million in 2000 and \$1.1 million in 1999 and 1998. Included in these amounts are \$185,600 in 2000, \$415,000 in 1999 and \$380,000 in 1998 related to office facilities leased from companies owned beneficially either by one of our Co-Chairmen or by a Co-Chairman and a Director.

**NOTE 8 - INCOME TAXES**

Components of income tax expense are (in thousands):

	<b><u>2000</u></b>	<b><u>1999</u></b>	<b><u>1998</u></b>
Current taxes:			
Federal	\$ 18,255	\$ 5,748	\$ 561
State	<u>2,589</u>	<u>1,285</u>	<u>967</u>
	<u>20,844</u>	<u>7,033</u>	<u>1,528</u>
Deferred taxes:			
Federal	140	6,121	4,587
State	<u>16</u>	<u>115</u>	<u>382</u>
	<u>156</u>	<u>6,236</u>	<u>4,969</u>
Total	<u>\$ 21,000</u>	<u>\$ 13,269</u>	<u>\$ 6,497</u>

Deferred tax assets and liabilities have been recognized in the consolidated balance sheets due to the following temporary differences (in thousands):

	<b><u>12/31/00</u></b>	<b><u>12/31/99</u></b>
Warranty reserve.....	\$ 675	\$ 311
Real estate and fixed asset basis differences ....	324	374
Stock options .....	---	282
Sale/leaseback gain deferred .....	47	154
Other.....	<u>174</u>	<u>102</u>
	1,220	1,223
Deductible merger/acquisition costs.....	<u>(677)</u>	<u>(524)</u>
Net deferred tax asset .....	<u>\$ 543</u>	<u>\$ 699</u>

Management believes it is more likely than not that future operating results will generate sufficient taxable income to realize the net deferred tax asset.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

***Reconciliation of Effective Income Tax Expense:***

Income taxes differ for the years ended December 31, 2000, 1999 and 1998 from the amounts computed using the federal statutory income tax rate as a result of the following (in thousands):

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Expected taxes at current federal statutory income tax rate	\$ 19,299	\$ 10,953	\$ 10,678
State income taxes	1,719	890	967
Utilization of NOL	---	---	(5,709)
Alternative minimum tax	---	---	561
Non-deductible merger/acquisition costs and other	(18)	1,426	---
Income tax expense	<u>\$ 21,000</u>	<u>\$ 13,269</u>	<u>\$ 6,497</u>

**NOTE 9 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

	<b>Home Sales <u>Revenue</u></b>	<b><u>Net Earnings</u></b> <small>(in thousands, except per share amounts)</small>	<b>Basic Earnings <u>Per Share</u></b>	<b>Diluted Earnings <u>Per Share</u></b>
<b><u>2000 - Three months ended:</u></b>				
March 31	\$ 91,653	\$ 4,771	\$ .90	\$ .82
June 30	120,802	8,573	1.62	1.50
September 30	134,464	10,509	2.06	1.85
December 31	168,509	11,909	2.38	2.12
<b><u>1999 - Three months ended:</u></b>				
March 31	\$ 51,306	\$ 2,325	\$ .43	\$ .38
June 30	76,647	4,541	.83	.75
September 30	76,786	4,027	.74	.67
December 31	129,268	8,052	1.50	1.37

**NOTE 10 – SEGMENT INFORMATION**

We classify our operations into three primary geographic segments: Texas, Arizona and California. These segments generate revenues through the sales of homes to external customers. We are not dependent on any one major customer.

Operational information relating to the different business segments follows. Information has been included for the California operations from July 1, 1998, the acquisition date. Certain information has not been included by segment due to the immateriality of the amount to the segment or in total. We evaluate segment performance based on several factors, of which the primary financial measure is earnings before interest and taxes (EBIT). The accounting policies of the business segments are the same as those described in Notes 1 and 2. There are no significant transactions between segments.

**MERITAGE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

	<b><u>Years Ended December 31,</u></b>		
	<b><u>2000</u></b>	<b><u>1999</u></b> (in thousands)	<b><u>1998</u></b>
<b><u>Home Sales Revenue:</u></b>			
Texas	\$ 214,472	\$ 174,850	\$ 130,860
Arizona	175,674	120,909	105,942
California	<u>125,282</u>	<u>38,248</u>	<u>19,183</u>
Total	<u>\$ 515,428</u>	<u>\$ 334,007</u>	<u>\$ 255,985</u>
<b><u>EBIT:</u></b>			
Texas	\$ 35,082	\$ 22,652	\$ 18,300
Arizona	17,666	14,515	12,918
California	16,819	4,185	1,858
Corporate and other	<u>(3,626)</u>	<u>(4,094)</u>	<u>1,504</u>
Total	<u>\$ 65,941</u>	<u>\$ 37,258</u>	<u>\$ 34,580</u>
<b><u>Amortization of Capitalized Interest:</u></b>			
Texas	\$ 2,416	\$ 1,758	\$ 1,143
Arizona	5,013	2,777	2,410
California	<u>1,742</u>	<u>501</u>	<u>66</u>
Total	<u>\$ 9,171</u>	<u>\$ 5,036</u>	<u>\$ 3,619</u>
		<b><u>December 31,</u></b>	
	<b><u>2000</u></b>	<b><u>1999</u></b> (in thousands)	<b><u>1998</u></b>
<b><u>Assets at Year End:</u></b>			
Texas	\$ 108,238	\$ 97,832	\$ 64,448
Arizona	102,746	77,195	58,758
California	53,723	43,773	12,321
Corporate and other	<u>2,368</u>	<u>7,759</u>	<u>16,723</u>
Total	<u>\$ 267,075</u>	<u>\$ 226,559</u>	<u>\$ 152,250</u>

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

## **PART III**

### **Item 10. Directors and Executive Officers of the Registrant**

Information required by this item is included under the captions “Election of Directors,” “Director and Officer Information,” and “Section 16(a) Beneficial Ownership Reporting Compliance” in our Notice and Proxy Statement relating to our 2001 Annual Meeting of Stockholders and is incorporated by reference into this Form 10-K Report. With the exception of the foregoing information and other information specifically incorporated by reference into this Form 10-K Report, our 2001 Proxy Statement is not being filed as a part of this report.

### **Item 11. Executive Compensation**

Information required by this item is included under the captions “Executive Compensation,” “Director Compensation” and “Employment Agreements” in our 2001 Proxy Statement and is incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management**

Information required by this item is included under the caption “Security Ownership of Principal Stockholders and Management” in our 2001 Proxy Statement and is incorporated herein by reference.

### **Item 13. Certain Relationships and Related Transactions**

Information required by this item is included under the caption “Certain Transactions and Relationships” in our 2001 Proxy Statement and is incorporated herein by reference.

**PART IV**

**Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

	<b>Page or Method of Filing</b>
<b>(a) Financial Statements and Schedules</b>	
(i) Financial Statements:	
(1) Report of KPMG LLP	Page 22
(2) Consolidated Financial Statements and Notes to Consolidated Financial Statements of the Company, including Consolidated Balance Sheets as of December 31, 2000 and 1999 and related Consolidated Statements of Earnings, Stockholders' Equity and Cash Flows for each of the years in the three-year period ended December 31, 2000	Page 23
(ii) Financial Statement Schedules:	
Schedules have been omitted because of the absence of conditions under which they are required or because the required material information is included in the Consolidated Financial Statements or Notes to the Consolidated Financial Statements included herein.	

**(b) Reports on Form 8-K**

We filed no reports on Form 8-K in the fourth quarter of 2000.

**(c) Exhibits**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>	<b><u>Page or Method of Filing</u></b>
2.1	Agreement and Plan of Reorganization, dated as of September 13, 1996, by and among Homeplex, the Monterey Merging Companies and the Monterey Stockholders	Incorporated by reference to Exhibit 2 of Form S-4 Registration Statement No. 333-15937 ("S-4 #333-15937").
2.2	Agreement of Purchase and Sale of Assets, dated as of May 20, 1997, by and among Monterey, Legacy Homes, Ltd., Legacy Enterprises, Inc., and John and Eleanor Landon	Incorporated by reference to Exhibit 2 of Form 8-K/A dated June 18, 1997.
2.3	Agreement of Purchase and Sale of Assets, dated as of June 15, 1998, by and among the Company, Sterling Communities, S.H. Capital, Inc., Sterling Financial Investments, Inc. Steve Hafener, and W. Leon Pyle	Incorporated by reference to Exhibit 2.2 of Form 10-Q for the quarterly period ended June 30, 1998.
3.1	Restated Articles of Incorporation of the Company	Incorporated by reference to Exhibit 3.2 of Form 10-Q for the quarterly period ended September 30, 1998.
3.2	Amendment to Articles of Incorporation	Incorporated by reference to Exhibit 3.1 of Form 10-Q for the quarterly period ended September 30, 1998.
3.3	Amended and Restated Bylaws of the Company	Incorporated by reference to Exhibit 3.3 of Form S-3 #333-58793.

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>	<b><u>Page or Method of Filing</u></b>
4.1	Specimen of Common Stock Certificate	Incorporated by reference to Exhibit 4 to the Form 10-K for the year ended December 31, 1996.
4.2	Note Purchase Agreement	Incorporated by reference to Exhibit 4.1 of Form 10-Q for the quarterly period ended September 30, 1998.
10.1	\$70 Million Borrowing Base Loan Agreement by and among the Company, Norwest Bank, Arizona, N.A. and California Bank and Trust, Dated as of September 15, 1999	Incorporated by reference to Exhibit 10.4 to the Form 10-K for the year ended December 31, 1999.
10.1.1	Modification to Loan Agreement with Wells Fargo Bank, Arizona, N.A. and California Bank and Trust, Dated as of May 16, 2000	Incorporated by reference to Exhibit 10.1 to the Form 10-Q for the quarterly period ended June 30, 2000.
10.2	\$15 Million Credit Agreement by and among Meritage Corporation and California Bank and Trust, Dated as of September 15, 1999	Incorporated by reference to Exhibit 10.23 of Form 10-Q for the quarterly period ended September 30, 1999.
10.3	Modification to Guaranty Federal Bank Loan, Dated as of May 19, 1998	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarterly period ended June 30, 1998.
10.3.1	Modification to Guaranty Federal Bank Loan, Dated as of July 31, 1999	Incorporated by reference to Exhibit 10.4 to the Form 10-K for the year ended December 31, 1999.
10.3.2	Modification to Guaranty Federal Bank Loan, Dated as of March 29, 2000	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarterly period ended March 31, 2000.
10.3.3	Extension of Guaranty Federal Bank Loan, Dated as of July 31, 2000	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarterly period ended June 30, 2000.
10.3.4	Modification to Guaranty Federal Bank Loan, Dated as of July 31, 2000	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarterly period ended September 30, 2000.
10.4	\$3.3 Million Construction Loan Agreement by and between the Company and Compass Bank, Dated as of February 10, 2000	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarterly period ended March 31, 2000.
10.5	Stock Option Plan*	Incorporated by reference to Exhibit 10(d) of Form 10-K for the fiscal year ended December 31, 1995 (“1995 Form 10-K”).
10.5.1	Amendment to Stock Option Plan *	Incorporated by reference to Exhibit 10(e) of 1995 Form 10-K.
10.6	Meritage Corporation Stock Option Plan*	Incorporated by reference to Exhibit 10.9 to the Form 10-K for the year ended December 31, 1996.

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>	<b><u>Page or Method of Filing</u></b>
10.6.1	Amendment to Stock Option Plan dated December 31, 1996*	Incorporated by reference to Exhibit 10.9 of Registration Statement No. 333-29737, filed on June 20, 1997.
10.7	Meritage Corporation 1997 Stock Option Plan*	Incorporated by reference to Exhibit 4.1 of Registration Statement No. 333-37859, filed on October 14, 1997.
10.7.1	Amended 1997 Stock Option Plan *	Incorporated by reference to Exhibit 4.1 of Registration Statement No. 333-75639 filed on April 2, 1999.
10.7.2	Amended 1997 Stock Option Plan *	Incorporated by reference to Exhibit 4.1 of Registration Statement No. 333-39036 filed on June 12, 2000.
10.8	Employment Agreement between the Company and William W. Cleverly*	Incorporated by reference to Exhibit 10.10 to the Form 10-K for the year ended December 31, 1996.
10.9	Separation and Consulting Agreement between the Company and William W. Cleverly*	Incorporated by reference to Exhibit C of the Form 8-K filed on March 23, 1999.
10.10	Employment Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.11 to the Form 10-K for the year ended December 31, 1996.
10.11	Employment Agreement between the Company and John R. Landon*	Incorporated by reference to Exhibit C of the Form 8-K filed on June 18, 1997.
10.12	Stock Option Agreement between the Company and William W. Cleverly*	Incorporated by reference to Exhibit 10.12 of the Form 10-K for the year ended December 31, 1996.
10.13	Stock Option Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.13 to the Form 10-K for the year ended December 31, 1996.
10.14	Stock Option Agreement between the Company and John R. Landon*	Incorporated by reference to Exhibit C of the Form 8-K filed on June 18, 1997.
10.15	Registration Rights Agreement between the Company and William W. Cleverly*	Incorporated by reference to Exhibit 10.14 to the Form 10-K for the year ended December 31, 1996.
10.16	Registration Rights Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.15 to the Form 10-K for the year ended December 31, 1996.
10.17	Registration Rights Agreement between the Company and John R. Landon*	Incorporated by reference to Exhibit C of the Form 8-K filed on June 18, 1997.
10.18	Escrow and Contingent Stock Agreement*	Incorporated by reference to Exhibit 10.16 of the Form 10-K for the year ended December 31, 1996.

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>	<b><u>Page or Method of Filing</u></b>
10.19	Employment Agreement between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarterly period ended June 30, 1998.
10.19.1	Amendment to Employment Agreement between the Company and Larry W. Seay*	Filed herewith.
10.20	Change of Control Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.3 of Form 10-Q for the quarterly period ended March 30, 2000.
10.21	Change of Control Agreement between the Company and John R. Landon*	Incorporated by reference to Exhibit 10.4 of Form 10-Q for the quarterly period ended March 30, 2000.
10.22	Change of Control Agreement between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.5 of Form 10-Q for the quarterly period ended March 30, 2000.
10.23	Change of Control Agreement between the Company and Richard T. Morgan*	Incorporated by reference to Exhibit 10.6 of Form 10-Q for the quarterly period ended March 30, 2000.
24	Consent of KPMG LLP	Filed herewith.
25	Powers of Attorney	See signature page.

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\*Indicates a management contract or compensation plan.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, this 23rd day of March 2001.

MERITAGE CORPORATION,  
a Maryland Corporation

By /s/ STEVEN J. HILTON  
Steven J. Hilton  
*Co-Chairman and Chief Executive Officer*

By /s/ JOHN R. LANDON  
John R. Landon  
*Co-Chairman and Chief Executive Officer*

## POWER OF ATTORNEY

**KNOW ALL MEN BY THESE PRESENTS**, that each person whose signature appears below constitutes and appoints Steven J. Hilton, John R. Landon and Larry W. Seay, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Form 10-K Annual Report, and to file the same, with all exhibits thereto and other documents in connection therewith the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act of things requisite and necessary to be done in and about the premises, as fully and to all intents and purposes as he might or could do in person hereby ratifying and confirming all that said attorneys-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to these requirements of the Securities Exchange Act of 1934, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report on Form 10-K below:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ STEVEN J. HILTON</u> Steven J. Hilton	Co-Chairman and Chief Executive Officer	March 28, 2001
<u>/s/ JOHN R. LANDON</u> John R. Landon	Co-Chairman and Chief Executive Officer	March 28, 2001
<u>/s/ LARRY W. SEAY</u> Larry W. Seay	Chief Financial Officer, Vice President-Finance, Secretary and Treasurer (Principal Financial and Accounting Officer)	March 28, 2001
<u>/s/ WILLIAM W. CLEVERLY</u> William W. Cleverly	Director	March 28, 2001
<u>/s/ RAYMOND OPPEL</u> Raymond Oppel	Director	March 28, 2001
<u>/s/ ROBERT G. SARVER</u> Robert G. Sarver	Director	March 28, 2001
<u>/s/ C. TIMOTHY WHITE</u> C. Timothy White	Director	March 28, 2001
<u>/s/ PETER L. AX</u> Peter L. Ax	Director	March 28, 2001

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# corporate information

## Corporate Offices:

Meritage Corporation  
6613 North Scottsdale Road  
Suite 200  
Scottsdale, AZ 85250  
480-998-8700

Meritage Corporation  
4050 West Park Boulevard  
Plano, TX 75093  
972-612-8085

www.meritagehomes.com

## Annual Meeting

May 9, 2001 at 9:00 a.m.  
Hilton Scottsdale Resort  
6333 North Scottsdale Road  
Scottsdale, AZ 85250

## Transfer Agent & Registrar

Mellon Investor Services LLC  
85 Challenger Road  
Ridgefield Park, NJ 07600  
www.mellon-investor.com  
1-800-356-2017

## Corporate Counsel

Snell & Wilmer  
Phoenix, Arizona

## Auditors

KPMG LLP  
Phoenix, Arizona

## Form 10-K

A copy of our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, is available without charge upon written request to:

## Investor Relations

Vicki L. Biggs  
Meritage Corporation  
6613 North Scottsdale Road  
Suite 200  
Scottsdale, AZ 85250

## Corporate Communications

Jane S. Hays  
Meritage Corporation  
4050 West Park Boulevard  
Plano, TX 75093

## Common Stock Price Range

The common stock is traded on the New York Stock Exchange, Symbol MTH.

2000 Quarter Ended	High	Low	1999 Quarter Ended	High	Low
March 31	\$11.38	\$ 8.88	March 31	\$15.69	\$11.00
June 30	11.88	10.00	June 30	13.50	10.94
September 30	18.25	10.69	September 30	13.25	10.69
December 31	38.06	18.25	December 31	12.00	9.94

As of March 15, 2001, there were approximately 290 holders of record representing an estimated 2,500 beneficial owners of Meritage common stock. The company does not pay dividends on its common stock.

## DIRECTORS AND OFFICERS

Board of Directors	Corporate Officers	Legacy Homes-Texas www.legacy-homes.com	Monterey Homes / Meritage Homes-Arizona
Steven J. Hilton <i>Co-Chairman and Chief Executive Officer</i>	Steven J. Hilton <i>Co-Chairman and Chief Executive Officer</i>	Stewart H. Parker <i>Division President-Dallas/Fort Worth</i>	David A. Walls <i>Division President Monterey Homes-Scottsdale www.montereyhomesphoenix.com</i>
John R. Landon <i>Co-Chairman and Chief Executive Officer</i>	John R. Landon <i>Co-Chairman and Chief Executive Officer</i>	Richard L. Harvey <i>Division President-Austin</i>	J. Patrick Moroney <i>Division President Meritage Homes-Phoenix www.meritagehomesphoenix.com</i>
Peter Ax (1) (2) <i>Chief Executive Officer Phoenix Capital Management, LLC</i>	Larry W. Seay <i>Chief Financial Officer Vice President-Finance Secretary &amp; Treasurer</i>	Michael J. Pizzitola <i>Division President-Houston</i>	Jeffrey R. Grobstein <i>Division President Monterey Homes-Tucson www.montereyhomestucson.com</i>
William W. Cleverly <i>Chief Executive Officer Inca Capital</i>	Richard T. Morgan <i>Vice President</i>	Jane S. Hays <i>Vice President-Corporate Development</i>	Roger A. Zetah <i>Vice President-Chief Financial Officer</i>
Raymond (Ray) Oppel (1) (2) <i>Private Investor</i>		Richard T. Morgan <i>Vice President-Finance Chief Financial Officer</i>	
Robert G. Sarver (1) (2) <i>Chairman and Chief Executive Officer California Bank and Trust</i>		<b>Meritage Homes-California</b> www.meritagehomes-ca.com	
C. Timothy White <i>Partner Tiffany &amp; Bosco, P.A.</i>		Steven W. Hafener <i>Regional President</i>	
		Michael V. Anderson <i>Division President-Sacramento</i>	
		Bruce S. Garretson <i>Vice President-Controller</i>	

(1) Audit Committee

(2) Compensation Committee



MONTEREY HOMES  
LUXURY COMMUNITIES

*LEGACY HOMES*  
A MERITAGE CO.

  
MERITAGE HOMES

SCOTTSDALE PHOENIX TUCSON • DALLAS/FT. WORTH AUSTIN HOUSTON • SAN FRANCISCO SACRAMENTO

