Forestar Group Inc.
Form 10-Q
August 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

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: 001-33662

FORESTAR GROUP INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	26-1336998
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

6300 Bee Cave Road, Building Two, Suite 500, Austin, Texas 78746
(Address of Principal Executive Offices, Including Zip Code)
(512) 433-5200
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

Title of Each Class	Number of Shares Outstanding as of August 3, 2015
Common Stock, par value $1.00 per share	33,614,877

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
FORESTAR GROUP INC.
Consolidated Balance Sheets
(Unaudited)

	Second Quarter-End 2015	Year-End 2014
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	$98,761	$170,127
Real estate, net	603,525	575,756
Oil and gas properties and equipment, net	224,465	263,493
Investment in unconsolidated ventures	76,722	65,005
Timber	8,360	8,315
Receivables, net	14,610	24,589
Income taxes receivable	3,930	7,503
Prepaid expenses	3,502	6,000
Property and equipment, net	10,850	11,627
Deferred tax asset, net	65,327	40,624
Goodwill and other intangible assets	65,583	66,131
Other assets	16,684	19,029
TOTAL ASSETS	$1,192,319	$1,258,199
LIABILITIES AND EQUITY		
Accounts payable	$9,903	$20,400
Accrued employee compensation and benefits	3,801	8,323
Accrued property taxes	5,599	5,966
Accrued interest	3,458	3,451
Earnest money deposits	8,997	10,045
Other accrued expenses	27,433	35,729
Other liabilities	27,907	31,799
Debt	434,840	432,744
TOTAL LIABILITIES	521,938	548,457
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Forestar Group Inc. shareholders' equity:		
Common stock, par value $1.00 per share, 200,000,000 authorized shares, 36,946,603 issued at second quarter-end 2015 and year-end 2014	36,947	36,947
Additional paid-in capital	560,264	558,945
Retained earnings	124,335	167,001
Treasury stock, at cost, 3,331,726 shares at second quarter-end 2015 and 3,485,278 shares at year-end 2014	(53,128)	(55,691)
Total Forestar Group Inc. shareholders' equity	668,418	707,202
Noncontrolling interests	1,963	2,540
TOTAL EQUITY	670,381	709,742
TOTAL LIABILITIES AND EQUITY	$1,192,319	$1,258,199

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income and Comprehensive Income
(Unaudited)

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales and other	$28,300	$44,124	$50,261	$99,671
Commercial and income producing properties	11,109	11,049	21,978	20,982
Real estate	39,409	55,173	72,239	120,653
Oil and gas	16,165	24,377	29,350	41,931
Other natural resources	1,856	3,463	3,646	5,034
	57,430	83,013	105,235	167,618
COSTS AND EXPENSES				
Cost of real estate sales and other	(13,890)	(23,419)	(24,252)	(49,483)
Cost of commercial and income producing properties	(7,548)	(8,606)	(15,240)	(18,726)
Cost of oil and gas producing activities	(70,141)	(16,926)	(81,683)	(29,546)
Cost of other natural resources	(860)	(801)	(1,780)	(1,577)
Other operating	(13,642)	(16,330)	(31,702)	(30,327)
General and administrative	(4,901)	(6,856)	(13,043)	(12,001)
	(110,982)	(72,938)	(167,700)	(141,660)
GAIN ON SALE OF ASSETS	838	16,867	2,014	16,867
OPERATING INCOME (LOSS)	(52,714)	26,942	(60,451)	42,825
Equity in earnings of unconsolidated ventures	5,584	958	8,629	1,949
Interest expense	(8,715)	(7,370)	(17,536)	(12,873)
Other non-operating income	783	2,269	1,700	4,563
INCOME (LOSS) BEFORE TAXES	(55,062)	22,799	(67,658)	36,464
Income tax benefit (expense)	20,744	(8,051)	25,103	(12,709)
CONSOLIDATED NET INCOME (LOSS)	(34,318)	14,748	(42,555)	23,755
Less: Net (income) loss attributable to noncontrolling interests	(189)	74	(110)	(599)
NET INCOME (LOSS) ATTRIBUTABLE TO FORESTAR GROUP INC.	$(34,507)	$14,822	$(42,665)	$23,156
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	34,278	35,458	34,223	35,407
Diluted	34,278	43,688	34,223	43,690
NET INCOME (LOSS) PER COMMON SHARE				
Basic	$(1.01)	$0.34	$(1.25)	$0.54
Diluted	$(1.01)	$0.34	$(1.25)	$0.53
TOTAL COMPREHENSIVE INCOME (LOSS)	$(34,507)	$14,822	$(42,665)	$23,156

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Cash Flows
(Unaudited)

	First Six Months	
	2015	2014
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income (loss)	$(42,555)	$23,755
Adjustments:		
Depreciation, depletion and amortization	23,360	17,927
Change in deferred income taxes	(25,103)	7,668
Equity in earnings of unconsolidated ventures	(8,629)	(1,949)
Distributions of earnings of unconsolidated ventures	5,089	1,768
Share-based compensation	3,327	3,532
Real estate cost of sales	24,151	47,976
Dry hole and unproved leasehold impairment costs	30,663	7,004
Real estate development and acquisition expenditures, net	(57,353)	(66,558)
Reimbursements from utility and improvement districts	7,154	6,618
Other changes in real estate	631	2,341
Changes in deferred income	137	1,141
Asset impairments	25,764	—
Gain on sale of assets	(2,014)	(16,867)
Other	1,565	1,144
Changes in:		
Notes and accounts receivable	8,144	(6,809)
Prepaid expenses and other	2,502	3,751
Accounts payable and other accrued liabilities	(17,919)	(9,156)
Income taxes	3,573	(4,291)
Net cash provided by (used for) operating activities	(17,513)	18,995
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software, reforestation and other	(6,971)	(9,823)
Oil and gas properties and equipment	(40,286)	(44,632)
Investment in unconsolidated ventures	(10,136)	(4,430)
Proceeds from sales of assets	2,984	11,022
Return of investment in unconsolidated ventures	1,960	155
Net cash used for investing activities	(52,449)	(47,708)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of senior secured notes, net	—	241,947
Payments of debt	(4,925)	(219,653)
Additions to debt	5,016	10,383
Deferred financing fees	(100)	(3,068)
Distributions to noncontrolling interests, net	(687)	(898)
Purchase of noncontrolling interests	—	(7,971)
Exercise of stock options	14	754
Payroll taxes on issuance of stock-based awards	(723)	(972)
Excess income tax benefit from share-based compensation	1	52
Net cash provided by (used for) financing activities	(1,404)	20,574
Net decrease in cash and cash equivalents	(71,366)	(8,139)

Cash and cash equivalents at beginning of period	170,127	192,307
Cash and cash equivalents at end of period	$98,761	$184,168

Please read the notes to consolidated financial statements.

FORESTAR GROUP INC.
Notes to Consolidated Financial Statements
(Unaudited)
Note 1—Basis of Presentation
Our consolidated financial statements include the accounts of Forestar Group Inc., all subsidiaries, ventures and other entities in which we have a controlling interest. We account for our investment in other entities in which we have significant influence over operations and financial policies using the equity method. We eliminate all material intercompany accounts and transactions. Noncontrolling interests in consolidated pass-through entities are recognized before income taxes.
We prepare our unaudited interim financial statements in accordance with U.S. generally accepted accounting principles and Securities and Exchange Commission requirements for interim financial statements. As a result, they do not include all the information and disclosures required for complete financial statements. However, in our opinion, all adjustments considered necessary for a fair presentation have been included. Such adjustments consist only of normal recurring items unless otherwise noted. We make estimates and assumptions about future events. Actual results can, and probably will, differ from those we currently estimate including those principally related to allocating costs to real estate, measuring long-lived assets for impairment, oil and gas revenue accruals, capital expenditure and lease operating expense accruals associated with our oil and gas production activities, oil and gas reserves and depletion of our oil and gas properties. These interim operating results are not necessarily indicative of the results that may be expected for the entire year. For further information, please read the financial statements included in our 2014 Annual Report on Form 10-K.
Note 2—New and Pending Accounting Pronouncements
Pending Accounting Standards
In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for annual and interim periods beginning after December 15, 2016. In July 2015, the FASB decided to defer the effective date of the new standard by one year. This proposed deferral would result in the new standard being effective after December 15, 2017. We have not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.
In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis (Topic 810), requiring entities to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The revised consolidation model: (1) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, (2) eliminates the presumption that a general partner should consolidate a limited partnership, (3) affects the consolidation analysis of reporting entities that are involved with VIEs, and (4) provides a scope exception from consolidation guidance for reporting entities with interests in certain legal entities. The updated standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2015. Early adoption is permitted. The updated standard may be applied retrospectively or using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. We are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.
In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The updated standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2015. The updated standard is not expected to materially impact our financial position or disclosures.

In April 2015, the FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (Subtopic 350-40), in order to provide clarification on whether a cloud computing arrangement includes a software license. If a software license is included, the customer should account for the license consistent with its accounting of other software licenses. If a software license is not included, the arrangement should be accounted for as a service contract. The update is effective for reporting periods beginning after December 15, 2015. Early adoption is permitted. We are currently evaluating the effect that the updated standard will have on our financial position and disclosures.

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In June 2015, FASB issued Accounting Standards Update (ASU) No. 2015-10, Technical Corrections and Updates. The amendments in this update cover a wide range of topics in the codification and are generally categorized as follows: Amendments Related to Differences between Original Guidance and the Codification; Guidance Clarification and Reference Corrections; Simplification; and, Minor Improvements. The amendments are effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to impact our financial position or results of operations.

Note 3—Real Estate

Real estate consists of:

	Second Quarter-End 2015			Year-End 2014		
	Carrying Value	Accumulated Depreciation	Net Carrying Value	Carrying Value	Accumulated Depreciation	Net Carrying Value
	(In thousands)					
Entitled, developed and under development projects	$345,181	$ —	$345,181	$321,273	$ —	$321,273
Undeveloped land (includes land in entitlement)	93,013	—	93,013	93,182	—	93,182
Commercial						
Radisson Hotel	61,628	(27,536)	34,092	59,773	(29,062)	30,711
Harbor Lakes golf course and country club	—	—	—	2,054	(1,508)	546
Income producing properties						
Eleven	53,901	(1,734)	52,167	53,958	(576)	53,382
Midtown	34,933	(963)	33,970	33,293	(231)	33,062
Dillon [(a)]	15,870	—	15,870	15,203	—	15,203
Music Row [(a)]	8,265	—	8,265	7,675	—	7,675
Downtown Edge	11,938	—	11,938	11,856	—	11,856
West Austin	9,029	—	9,029	8,866	—	8,866
	$633,758	$ (30,233)	$603,525	$607,133	$ (31,377)	$575,756

[(a)] Construction in progress.

Our estimated costs of assets for which we expect to be reimbursed by utility and improvement districts were $87,516,000 at second quarter-end 2015 and $65,212,000 at year-end 2014, including $44,063,000 at second quarter-end 2015 and $31,913,000 at year-end 2014 related to our Cibolo Canyons project near San Antonio, Texas. In first six months 2015, we have collected $7,154,000 in reimbursements that were previously submitted to these districts. At second quarter-end 2015, our inception to-date submitted and approved reimbursements for the Cibolo Canyons project were $65,438,000 of which we collected $33,552,000. These costs are principally for water, sewer and other infrastructure assets that we have incurred and submitted or will submit to utility or improvement districts for approval and reimbursement. We expect to be reimbursed by utility and improvement districts when these districts achieve adequate tax basis or otherwise have funds available to support payment.

Note 4—Oil and Gas Properties and Equipment, net

Net capitalized costs, utilizing the successful efforts method of accounting, related to our oil and gas producing activities follows:

	Second Quarter-End 2015	Year-End 2014
	(In thousands)	
Unproved oil and gas properties	$64,653	$90,446
Proved oil and gas properties	222,713	221,299

Total costs	287,366	311,745
Less: accumulated depreciation, depletion and amortization	(62,901)	(48,252)
	$224,465	$263,493

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We review unproved oil and gas properties for impairment based on our current exploration plans and proved oil and gas properties by comparing the expected undiscounted future cash flows at a producing field level to the unamortized capitalized cost of the asset. In second quarter 2015, we recognized non-cash impairment charges of $20,903,000 on our unproved leasehold interests and $25,035,000 on our proved properties principally due to a significant decline in oil prices, drilling results, a change in our plans to develop acreage and increased likelihood that these non-core oil and gas assets in Oklahoma, Nebraska and Kansas will be sold. Impairment charges are included in cost of oil and gas producing activities on our income statement. Dry hole costs in first six months 2015 were $9,752,000, which includes a $9,674,000 charge in second quarter 2015 primarily associated with an exploratory well in Oklahoma. In addition, in second quarter 2015 we expensed $917,000 of capitalized costs related to pre-drilling activities associated with non-core oil and gas properties in Oklahoma.

In first six months 2015, we recorded a net gain of $854,000 on the sale of 17,168 net mineral acres leased from others in Nebraska and North Dakota and the disposition of 2 gross (1 net) producing oil and gas wells in Nebraska and Oklahoma for total proceeds of $2,524,000.

Note 5—Goodwill and Other Intangible Assets

Carrying value of goodwill and other intangible assets follows:

	Second Quarter-End	Year-End
	2015	2014
	(In thousands)	
Goodwill	$63,355	$63,423
Identified intangibles, net	2,228	2,708
	$65,583	$66,131

Goodwill related to our oil and gas properties is $59,481,000 and $59,549,000 at second quarter-end 2015 and year-end 2014. Goodwill associated with our water resources company acquired in 2010 is $3,874,000 at second quarter-end 2015 and year-end 2014. The change in goodwill for oil and gas properties is related to goodwill allocated to proved properties in first six months 2015.

Identified intangibles include $1,681,000 in indefinite lived groundwater leases associated with a water resources company acquired in 2010, $217,000 related to in-place tenant leases with definite lives associated with the purchase of our partner's interest in the Eleven multifamily venture and $330,000 related to patents with definite lives associated with the Calliope Gas Recovery System, a process to increase natural gas production.

Note 6—Equity

A reconciliation of changes in equity at second quarter-end 2015 follows:

	Forestar Group Inc.	Noncontrolling Interests	Total
	(In thousands)		
Balance at year-end 2014	$707,202	$2,540	$709,742
Net income (loss)	(42,665)	110	(42,555)
Distributions to noncontrolling interests	—	(687)	(687)
Other (primarily share-based compensation)	3,881	—	3,881
	$668,418	$1,963	$670,381

Note 7—Investment in Unconsolidated Ventures

At second quarter-end 2015, we have ownership interests in 16 ventures that we account for using the equity method.

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Combined summarized balance sheet information for our ventures accounted for using the equity method follows:

	Venture Assets		Venture Borrowings[a]		Venture Equity		Our Investment	
	Second Quarter-End 2015	Year-End 2014	Second Quarter-End 2015	Year-End 2014	Second Quarter-End 2015	Year-End 2014	Second Quarter-End 2015	Year-End 2014
	(In thousands)							
242, LLC [b]	$29,618	$33,021	$1,268	$6,940	$26,661	$21,789	$12,642	$10,098
CL Ashton Woods, LP [c]	10,548	13,269	—	—	7,831	11,453	3,570	6,015
CL Realty, LLC	8,099	7,960	—	—	7,982	7,738	3,991	3,869
CREA FMF Nashville LLC [b]	55,028	40,014	46,322	29,660	5,771	5,987	5,300	5,516
Elan 99, LLC	17,250	10,070	1	1	14,548	9,643	13,094	8,679
FMF Littleton LLC	38,344	26,953	8,608	—	24,736	24,435	6,362	6,287
FMF Peakview LLC	47,753	43,638	27,790	23,070	17,210	17,464	3,524	3,575
HM Stonewall Estates, Ltd [c]	3,573	3,750	—	669	3,573	3,081	2,165	1,752
LM Land Holdings, LP [c]	32,070	25,561	9,284	4,448	20,442	18,500	10,609	9,322
Miramonte Boulder Pass, LLC	11,150	—	4,299	—	5,594	—	5,449	—
PSW Communities, LP	14,498	16,045	6,951	10,515	6,943	4,415	3,996	3,924
Temco Associates, LLC	11,406	11,756	—	—	11,014	11,556	5,507	5,778
Other ventures [d]	4,504	8,453	23,125	26,944	(25,729)	(25,614)	513	190
	$283,841	$240,490	$127,648	$102,247	$126,576	$110,447	$76,722	$65,005

Combined summarized income statement information for our ventures accounted for using the equity method follows:

	Venture Revenues				Venture Earnings (Loss)				Our Share of Earnings (Loss)			
	Second Quarter		First Six Months		Second Quarter		First Six Months		Second Quarter		First Six Months	
	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014
	(In thousands)											
242, LLC [b]	$12,368	$—	$17,699	$1,475	$4,409	$(53)	$7,873	$480	$2,279	$(26)	$4,045	$251
CL Ashton Woods, LP [c]	1,061	361	2,411	1,069	851	76	1,378	296	878	135	1,556	453
CL Realty, LLC	190	459	469	827	83	322	243	552	42	161	122	276
CREA FMF Nashville LLC [b]	29	—	35	—	(103)	—	(216)	(25)	(103)	—	(216)	(25)
Elan 99, LLC	—	—	—	—	—	—	(2)	—	—	—	(2)	—
FMF Littleton LLC	—	—	—	—	—	—	—	—	—	—	—	—
FMF Peakview LLC	466	—	652	—	(252)	(79)	(734)	(152)	(50)	(16)	(146)	(31)
HM Stonewall Estates, Ltd [c]	611	434	1,669	1,435	297	170	812	522	343	68	573	209

LM Land Holdings, LP [c]	4,321	4,395	6,297	9,293	2,538	4,044	3,788	6,971	923	1,220	1,287	1,897
Miramonte Boulder Pass, LLC	—	—	—	—	(49)	—	(49)	—	(25)	—	(25)	—
PSW Communities, LP	13,642	—	16,069	—	2,333	(4)	2,528	(220)	788	(6)	961	(195)
Temco Associates, LLC	1,086	654	1,144	714	460	134	459	116	230	67	230	58
Other ventures [d]	—	734	3,701	1,119	(55)	(579)	(258)	(840)	279	(645)	244	(944)
	$33,774	$7,037	$50,146	$15,932	$10,512	$4,031	$15,822	$7,700	$5,584	$958	$8,629	$1,949

(a) Total includes current maturities of $72,716,000 at second quarter-end 2015, of which $42,579,000 is non-recourse to us, and $65,795,000 at year-end 2014, of which $42,566,000 is non-recourse to us.

(b) Includes unamortized deferred gains on real estate contributed by us to ventures. We recognize deferred gains as income as real estate is sold to third parties. Deferred gains of $1,512,000 are reflected as a reduction to our investment in unconsolidated ventures at second quarter-end 2015.

(c) Includes unrecognized basis difference of $1,245,000 which is reflected as a reduction of our investment in unconsolidated ventures at second quarter-end 2015. The difference will be accreted as income or expense over the life of the investment and included in our share of earnings (loss) from the respective ventures.

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(d) Our investment in other ventures reflects our ownership interests, excluding venture losses that exceed our investment where we are not obligated to fund those losses. Please read Note 16—Variable Interest Entities for additional information.

In first six months 2015, we invested $10,136,000 in these ventures and received $7,049,000 in distributions. In first six months 2014, we invested $4,430,000 in these ventures and received $1,923,000 in distributions. Distributions include both return of investments and distribution of earnings.

Note 8—Receivables

Receivables consist of:

	Second Quarter-End 2015	Year-End 2014
	(In thousands)	
Oil and gas revenue accruals	$6,673	$7,293
Other receivables and accrued interest	4,171	6,505
Oil and gas joint interest billing receivables	2,055	5,738
Other loans secured by real estate, average interest rates of 10.68% at second quarter-end 2015 and 4.41% at year-end 2014	1,948	1,737
Loan secured by real estate	$—	$3,574
	14,847	24,847
Allowance for bad debts	(237)	(258)
	$14,610	$24,589

In second quarter 2011, we acquired a non-performing loan that was secured by a lien on developed and undeveloped real estate located near Houston designated for single-family residential and commercial development. In first quarter 2015, the loan was paid in full and we received principal payments of $4,394,000 and interest payments of $49,000.

Estimated accretable yield follows:

	Second Quarter-End 2015
	(In thousands)
Beginning of period (year-end 2014)	$839
Change in accretable yield due to change in timing of estimated cash flows	30
Interest income recognized (in first six months 2015)	(869)
End of period	$—

Other loans secured by real estate generally are secured by a deed of trust and due within three years.

Note 9—Debt

Debt consists of:

	Second Quarter-End 2015	Year-End 2014
	(In thousands)	
8.50% senior secured notes due 2022	$250,000	$250,000
3.75% convertible senior notes due 2020, net of discount	104,846	103,194
6.00% tangible equity unit notes, net of discount	13,008	17,154
Secured promissory notes — average interest rates of 3.19% at second quarter-end 2015 and 3.17% at year-end 2014	15,400	15,400
Other indebtedness — interest rates ranging from 2.19% to 5.50%	51,586	46,996
	$434,840	$432,744

Our debt agreements contain financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At second quarter-end 2015, we were in compliance with the financial covenants of these agreements.

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At second quarter-end 2015, our senior secured credit facility provides for a $300,000,000 revolving line of credit maturing May 15, 2017 (with two one-year extension options). The revolving line of credit may be prepaid at any time without penalty. The revolving line of credit includes a $100,000,000 sublimit for letters of credit, of which $14,816,000 is outstanding at second quarter-end 2015. Total borrowings under our senior secured credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula. At second quarter-end 2015, we had $285,184,000 in net unused borrowing capacity under our senior secured credit facility.

Under the terms of our senior secured credit facility, at our option we can borrow at LIBOR plus 4.0 percent or at the alternate base rate plus 3.0 percent. The alternate base rate is the highest of (i) KeyBank National Association's base rate, (ii) the federal funds effective rate plus 0.5 percent or (iii) 30 day LIBOR plus 1 percent. Borrowings under the senior secured credit facility are or may be secured by (a) mortgages on the timberland, high value timberland and portions of raw entitled land, as well as pledges of other rights including certain oil and gas operating properties, (b) assignments of current and future leases, rents and contracts, (c) a security interest in our primary operating account, (d) a pledge of the equity interests in current and future material operating subsidiaries and most of our majority-owned joint venture interests, or if such pledge is not permitted, a pledge of the right to distributions from such entities, and (e) a pledge of certain reimbursements payable to us from special improvement district tax collections in connection with our Cibolo Canyons project. The senior secured credit facility provides for releases of real estate and other collateral provided that borrowing base compliance is maintained.

At second quarter-end 2015, secured promissory notes represent a $15,400,000 loan collateralized by a 413 guest room hotel located in Austin with a carrying value of $34,092,000. Other indebtedness principally represents $47,388,000 of senior secured loans for two multifamily properties, our 257-unit multifamily project in Austin and our 354-unit multifamily property near Dallas. The combined carrying value of these two multifamily properties is $86,137,000 at second quarter-end 2015.

At second quarter-end 2015 and year-end 2014, we have $13,331,000 and $15,168,000 in unamortized deferred financing fees which are included in other assets. Amortization of deferred financing fees was $2,016,000 and $2,107,000 in first six months 2015 and 2014 and is included in interest expense.

Note 10—Fair Value

Fair value is the exchange price that would be the amount received for an asset or paid to transfer a liability in an orderly transaction between market participants. In arriving at a fair value measurement, we use a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable. The three levels of inputs used to establish fair value are the following:

- Level 1 — Quoted prices in active markets for identical assets or liabilities;
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Non-financial assets measured at fair value on a non-recurring basis principally include real estate assets, oil and gas properties, assets held for sale, goodwill and other intangible assets, which are measured for impairment.

In second quarter 2015, we recognized proved oil and gas property non-cash impairment charges of $25,035,000 principally due to a significant decline in oil prices, declining well performance and an increased likelihood that these non-core oil and gas assets in Oklahoma, Nebraska and Kansas will be sold. The fair value of these properties was determined using Level 3 inputs and the income valuation method. We used a discount rate of 10 percent as of second quarter-end 2015 which is commensurate with our risk and current market conditions associated with realizing the expected cash flows projected for these investments.

In first six months 2015, we recognized non-cash asset impairment charges of $729,000, of which $504,000 was recognized in first quarter 2015 related to a residential development with golf course and country club property located near Fort Worth which was sold in April 2015 and $225,000 was recognized in second quarter 2015 related to one owned project near Atlanta. Fair value of the one owned project near Atlanta was determined based on the present value of future estimated cash flows expected from these properties.

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	Second Quarter-End 2015				Year-End 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(In thousands)							
Non-Financial Assets and Liabilities:								
Real estate	$—	$70	$—	$70	$—	$970	$—	$970
Proved oil and gas properties	$—	$—	$28,359	$28,359	$—	$—	$3,655	$3,655

We elected not to use the fair value option for cash and cash equivalents, accounts receivable, other current assets, variable debt, accounts payable and other current liabilities. The carrying amounts of these financial instruments approximate their fair values due to their short-term nature or variable interest rates. We determine the fair value of fixed rate financial instruments using quoted prices for similar instruments in active markets.

Information about our fixed rate financial instruments not measured at fair value follows:

	Second Quarter-End 2015		Year-End 2014		
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Valuation Technique
	(In thousands)				
Loan secured by real estate	$—	$—	$3,574	$4,859	Level 2
Fixed rate debt	$(367,854)	$(365,260)	$(370,348)	$(359,131)	Level 2

Note 11—Capital Stock

In first quarter 2015, we accelerated the expiration date of our shareholder rights plan from December 11, 2017 to March 13, 2015, resulting in termination of the plan.

Please read Note 17—Share-Based and Long-Term Incentive Compensation for information about additional shares of common stock that could be issued under terms of our share-based compensation plans.

At second quarter-end 2015, personnel of former affiliates held options to purchase 510,000 shares of our common stock. The options have a weighted average exercise price of $28.42 and a weighted average remaining contractual term of one year. At second quarter-end 2015, the options have an aggregate intrinsic value of $17,700.

Note 12—Net Income (Loss) per Share

Basic and diluted earnings per share is computed using the two-class method. The two-class method is an earnings allocation formula that determines net income per share for each class of common stock and participating security. We have determined that our 6.00% tangible equity units (Units) are participating securities. Per share amounts are computed by dividing earnings available to common shareholders by the weighted average shares outstanding during each period. In periods with a net loss, no such adjustment is made to earnings as the holders of the participating securities have no obligation to fund losses.

Due to a net loss in second quarter and first six months 2015, as the effect of potentially dilutive securities would be anti-dilutive, basic and diluted loss per share are the same. The computations of basic and diluted earnings per share are as follows:

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	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Numerator:				
Consolidated net income (loss)	$(34,318)	$14,748	$(42,555)	$23,755
Less: Net loss (income) attributable to noncontrolling interest	(189)	74	(110)	(599)
Earnings (loss) available for diluted earnings per share	$(34,507)	$14,822	$(42,665)	$23,156
Less: Undistributed net income allocated to participating securities	—	(2,689)	—	(4,205)
Earnings (loss) available to common shareholders for basic earnings per share	$(34,507)	$12,133	$(42,665)	$18,951
Denominator:				
Weighted average common shares outstanding — basic	34,278	35,458	34,223	35,407
Weighted average common shares upon conversion of participating securities (a)	—	7,857	—	7,857
Dilutive effect of stock options, restricted stock and equity-settled awards	—	373	—	426
Total weighted average shares outstanding — diluted	34,278	43,688	34,223	43,690
Anti-dilutive awards excluded from diluted weighted average shares	10,829	2,503	10,786	2,277

(a) Our earnings per share calculation reflects the weighted average shares issuable upon settlement of the prepaid stock purchase contract component of our 6.00% tangible equity units, issued November 27, 2013.

The actual number of shares we may issue upon settlement of the stock purchase contract will be between 6,547,800 shares (the minimum settlement rate) and 7,857,000 shares (the maximum settlement rate) based on the applicable market value, as defined in the purchase contract agreement associated with issuance of the Units.

We intend to settle the principal amount of our convertible senior notes (Convertible Notes) in cash upon conversion with only the amount in excess of par value of the Convertible Notes to be settled in shares of our common stock. Therefore, our calculation of diluted net income per share using the treasury stock method includes only the amount, if any, in excess of par value of the Convertible Notes. As such, the Convertible Notes have no impact on diluted net income per share until the price of our common stock exceeds the $24.49 conversion price of the Convertible Notes. The average price of our common stock in second quarter 2015 did not exceed the conversion price which resulted in no additional diluted outstanding shares.

Note 13—Income Taxes

Our effective tax rate was 38 percent in second quarter 2015 and 37 percent in first six months 2015. Our effective tax rate for first six months 2015 includes a one percent benefit for noncontrolling interests and a two percent detriment for a state valuation allowance and share-based compensation benefits that will not be realized. Our effective tax rate was 35 percent in second quarter 2014 and first six months 2014, which included a one percent benefit for noncontrolling interests. Our effective tax rates also include the effect of state income taxes, nondeductible items and benefits of percentage depletion.

We have not provided a valuation allowance for our federal deferred tax asset and the majority of our state deferred tax assets because, although realization is not assured, we believe it is more likely than not they will be recoverable in future periods based on considerations including taxable income in prior carryback years, future reversals of existing temporary differences, tax planning strategies and future taxable income. The amount of deferred tax assets considered recoverable, however, could be reduced if estimates of future taxable income are reduced due to additional oil and gas restructuring costs or other factors.

Note 14—Commitments and Contingencies

Litigation

We are involved in various legal proceedings that arise from time to time in the ordinary course of doing business and believe that adequate reserves have been established for any probable losses. We do not believe that the outcome of any of these proceedings should have a significant adverse effect on our financial position, long-term results of operations or cash flows. However, it is possible that charges related to these matters could be significant to our results or cash flows in any one accounting period.

Environmental

Environmental remediation liabilities arise from time to time in the ordinary course of doing business, and we believe we have established adequate reserves for any probable losses that we can reasonably estimate. We own 288 acres near Antioch,

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California, portions of which were sites of a former paper manufacturing operation that are in remediation. We have received certificates of completion on all but one 80 acre tract, a portion of which includes subsurface contamination. We estimate the remaining cost to complete remediation activities will be approximately $332,000, which is included in other accrued expenses. It is possible that remediation or monitoring activities could be required in addition to those included within our estimate, but we are unable to determine the scope, timing or extent of such activities.

We have asset retirement obligations related to the abandonment and site restoration requirements that result from the acquisition, construction and development of oil and gas properties. We record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Accretion expense related to the asset retirement obligation and depletion expense related to capitalized asset retirement cost is included in cost of oil and gas producing activities on our consolidated statements of income and comprehensive income. At second quarter-end 2015 and year-end 2014, our asset retirement obligation was $1,926,000 and $1,807,000, which is included in other liabilities.

Oil and Gas Restructuring Costs

In connection with review of strategic alternatives with respect to our oil and gas business that was announced in December 2014, we offered retention bonuses to key personnel provided they remain our employees through December 2015. We are expensing retention bonus costs over the retention period. In first six months 2015, we incurred severance expenses related to staff reductions, paid a portion of the December 2014 accrual under written severance agreements and incurred costs associated with closure of our Fort Worth office. Office closure costs include a $1,750,000 lease termination charge and $391,000 for write off of leasehold improvements which were partially offset by a deferred lease credit of $364,000. These restructuring costs are included in other operating expense on our consolidated statements of income and comprehensive income. We may incur additional costs related to our strategic initiatives associated with lowering capital expenditures and operating costs associated with our oil and gas business.

The following table summarizes activity related to liabilities associated with our oil and gas restructuring activities in first six months 2015:

	Employee-Related Costs	Lease Termination Charge	Total
	(In thousands)		
Balance at year-end 2014	$(2,367)	$—	$(2,367)
Additions	(1,574)	(1,750)	(3,324)
Payments	2,038	1,750	3,788
Balance at second quarter-end 2015	$(1,903)	$—	$(1,903)

Note 15—Segment Information

We manage our operations through three segments: real estate, oil and gas and other natural resources. Real estate secures entitlements and develops infrastructure on our lands for single-family residential and mixed-use communities, and manages our undeveloped land, commercial and income producing properties, primarily a hotel and our multifamily investments. Oil and gas is an independent oil and gas exploration, development and production operation and manages our owned and leased mineral interests. Other natural resources manages our timber, recreational leases and water resource initiatives.

Total assets allocated by segment are as follows:

	Second Quarter-End 2015	Year-End 2014
	(In thousands)	
Real estate	$689,409	$654,774
Oil and gas	295,759	342,703
Other natural resources	20,074	22,531
Assets not allocated to segments [(a)]	187,077	238,191
	$1,192,319	$1,258,199

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[a] Assets not allocated to segments at second quarter-end 2015 principally consist of cash and cash equivalents of $98,761,000 and a net deferred tax asset of $65,327,000. Assets not allocated to segments at year-end 2014 principally consist of cash and cash equivalents of $170,127,000 and a net deferred tax asset of $40,624,000.

We evaluate performance based on segment earnings (loss) before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures, gain on sales of assets, interest income on loans secured by real estate and net (income) loss attributable to noncontrolling interests. Items not allocated to our business segments consist of general and administrative expense, share-based and long-term incentive compensation, gain on sale of strategic timberland, interest expense and other corporate non-operating income and expense. The accounting policies of the segments are the same as those described in Note 1—Basis of Presentation. Our revenues are derived from U.S. operations and all of our assets are located in the U.S. In second quarter 2015, no single customer accounted for more than ten percent of our total revenues.

Segment revenues and earnings are as follows:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Revenues:				
Real estate	$39,409	$55,173	$72,239	$120,653
Oil and gas	16,165	24,377	29,350	41,931
Other natural resources	1,856	3,463	3,646	5,034
Total revenues	$57,430	$83,013	$105,235	$167,618
Segment earnings (loss):				
Real estate	$15,527	$27,297	$24,593	$50,872
Oil and gas	(56,867)	9,522	(59,808)	10,329
Other natural resources	(43)	2,079	(434)	1,551
Total segment earnings (loss)	(41,383)	38,898	(35,649)	62,752
Items not allocated to segments [a]	(13,868)	(16,025)	(32,119)	(26,887)
Income (loss) before taxes attributable to Forestar Group Inc.	$(55,251)	$22,873	$(67,768)	$35,865

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[a] Items not allocated to segments consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
General and administrative expense	$(5,177)	$(5,566)	$(11,197)	$(10,734)
Shared-based and long-term incentive compensation expense	(23)	(3,219)	(3,481)	(3,532)
Interest expense	(8,715)	(7,370)	(17,536)	(12,873)
Other corporate non-operating income	47	130	95	252
	$(13,868)	$(16,025)	$(32,119)	$(26,887)

Note 16—Variable Interest Entities

We participate in real estate ventures for the purpose of acquiring and developing residential, multifamily and mixed-use communities in which we may or may not have a controlling financial interest. Generally accepted accounting principles require consolidation of Variable Interest Entities (VIEs) in which an enterprise has a controlling financial interest and is the primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the VIE activities that most significantly impact economic performance and (b) the obligation to absorb the VIE losses and right to receive benefits that are significant to the VIE. We examine specific criteria and use judgment when determining whether we are the primary beneficiary and must consolidate a VIE. We perform this review initially at the time we enter into venture agreements and continuously reassess to see if we are the primary beneficiary of a VIE.

At second quarter-end 2015, we have four VIEs. We account for these VIEs using the equity method and we are not the primary beneficiary. Although we have certain rights regarding major decisions, we do not have the power to direct the activities that are most significant to the economic performance of these VIEs. At second quarter-end 2015, these VIEs have total assets of $73,836,000, substantially all of which represent developed and undeveloped real estate, and total liabilities of

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$87,046,000, which includes $30,075,000 of borrowings classified as current maturities. These amounts are included in the summarized balance sheet information for ventures accounted for using the equity method in Note 7—Investment in Unconsolidated Ventures. At second quarter-end 2015, our investment in these VIEs is $9,682,000 and is included in investment in unconsolidated ventures. In first six months 2015, we contributed $74,000 to these VIEs. Our maximum exposure to loss related to one of these VIEs is estimated at $3,843,000, which exceeds our investment as we have a nominal general partner interest and could be held responsible for its liabilities. The maximum exposure to loss represents the maximum loss that we could be required to recognize assuming all the ventures' assets (principally real estate) are worthless, without consideration of the probability of a loss or of any actions we may take to mitigate any such loss.

Note 17—Share-Based and Long-Term Incentive Compensation

Share-based and long-term incentive compensation expense consists of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Cash-settled awards	$(1,447)	$1,488	$(1,151)	$(1,195)
Equity-settled awards	918	1,241	2,915	3,590
Restricted stock	(20)	33	(3)	79
Stock options	534	457	1,566	1,058
Total share-based compensation	(15)	3,219	3,327	3,532
Deferred cash	38	—	154	—
	$23	$3,219	$3,481	$3,532

Share-based and long-term incentive compensation expense is included in:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
General and administrative expense	$(276)	$1,290	$1,846	$1,267
Other operating expense	299	1,929	1,635	2,265
	$23	$3,219	$3,481	$3,532

Share-Based Compensation

In first six months 2015, we granted 89,900 cash-settled stock appreciation rights awards and 598,600 equity-settled awards. Cash-settled stock appreciation rights have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, or disability or if there is a change in control. Equity-settled awards granted to employees in the first six months 2015 include market-leveraged stock units (MSUs) and stock options. Equity-settled MSUs will be settled in common stock based upon our stock price performance over three years from the date of grant. Stock options have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, or disability or if there is a change in control. Equity-settled awards in the form of restricted stock units granted to our directors are fully vested at the time of grant and are issued upon retirement.

The fair value of awards granted to retirement eligible employees expensed at the date of grant was $517,000 and $760,000 in first six months 2015 and 2014. Unrecognized share-based compensation expense related to non-vested equity-settled awards, restricted stock and stock options is $8,843,000 at second quarter-end 2015.

In first six months 2015 and 2014, we issued 157,201 and 162,380 shares out of our treasury stock associated with vesting of stock-based awards or exercise of stock options, net of 48,636 and 51,681 shares withheld having a value of $723,000 and $972,000 for payroll taxes in connection with vesting of stock-based awards or exercise of stock options.

Long-Term Incentive Compensation

In first six months 2015, we granted $587,000 of long-term incentive compensation in the form of deferred cash compensation. Deferred cash will be paid out after the earlier of three years or the employee's retirement eligibility date and the expense is recognized ratably over the vesting period. The accrued liability was $154,000 at second quarter-end 2015 and is included in other liabilities.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2014 Annual Report on Form 10-K. Unless otherwise indicated, information is presented as of second quarter-end 2015, and references to acreage owned includes all acres owned by ventures regardless of our ownership interest in a venture.

Forward-Looking Statements

This Quarterly Report on Form 10-Q and other materials we have filed or may file with the Securities and Exchange Commission contain "forward-looking statements" within the meaning of the federal securities laws. These forward-looking statements are identified by their use of terms and phrases such as "believe," "anticipate," "could," "estimate," "likely," "intend," "may," "plan," "expect," and similar expressions, including references to assumptions. These statements reflect our current views with respect to future events and are subject to risks and uncertainties. We note that a variety of factors and uncertainties could cause our actual results to differ significantly from the results discussed in the forward-looking statements. Factors and uncertainties that might cause such differences include, but are not limited to:

- general economic, market or business conditions in Texas or Georgia, where our real estate activities are concentrated, or on a national or global scale;
- our ability to achieve some or all of our strategic initiatives;
- the opportunities (or lack thereof) that may be presented to us and that we may pursue;
- our ability to hire and retain key personnel;
- future residential, multifamily or commercial entitlements, development approvals and the ability to obtain such approvals;
- obtaining approvals of reimbursements and other payments from special improvement districts and the timing of such payments;
- accuracy of estimates and other assumptions related to investment in and development of real estate, the expected timing and pricing of land and lot sales and related cost of real estate sales, impairment of long-lived assets, income taxes, share-based compensation, oil and gas reserves, revenues, capital expenditures and lease operating expense accruals associated with our oil and gas working interests, and depletion of our oil and gas properties;
- the levels of resale housing inventory and potential impact of foreclosures in our mixed-use development projects and the regions in which they are located;
- fluctuations in costs and expenses, including impacts from shortages in materials or labor;
- demand for new housing, which can be affected by a number of factors including the availability of mortgage credit, job growth and fluctuations in commodity prices;
- demand for multifamily communities, which can be affected by a number of factors including local markets and economic conditions;
- competitive actions by other companies;
- changes in governmental policies, laws or regulations and actions or restrictions of regulatory agencies;
- risks associated with oil and gas exploration, drilling and production activities;
- fluctuations in oil and gas commodity prices;
- our ability to fully realize our deferred tax assets is dependent upon generating future taxable income, executing tax planning strategies, and reversals of existing taxable temporary differences;
- government regulation of exploration and production technology, including hydraulic fracturing;
- the results of financing efforts, including our ability to obtain financing with favorable terms, or at all;
- our ability to make interest and principal payments on our debt and satisfy the other covenants contained in our senior secured credit facility, indentures and other debt agreements;
- our partners' ability to fund their capital commitments and otherwise fulfill their operating and financial obligations;
- the effect of limitations, restrictions and natural events on our ability to harvest and deliver timber;
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inability to obtain permits for, or changes in laws, governmental policies or regulations affecting, water withdrawal or usage;

- the final resolutions or outcomes with respect to our contingent and other liabilities related to our business; and

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• our ability to execute our growth strategy and deliver acceptable returns from acquisitions and other investments.

Other factors, including the risk factors described in Item 1A of our 2014 Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Strategy

Our strategy is:

• Recognizing and responsibly delivering the greatest value from every acre; and
• Growing through strategic and disciplined investments.

2015 Strategic Initiatives

On May 12, 2015, we announced that as a result of its strategic review, our Board of Directors had unanimously approved and initiated a plan to focus on growing our core real estate business and maximizing long-term shareholder value through:

• Acquiring, entitling and developing residential and mixed-use communities,
• Investing in multifamily opportunities, including projects that provide additional recurring cash flow,
• Harvesting cash flow from oil and gas by significantly lowering capital investments and operating costs,
• Transitioning timberland into real estate properties.

Results of Operations

A summary of our consolidated results by business segment follows:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Revenues:				
Real estate	$39,409	$55,173	$72,239	$120,653
Oil and gas	16,165	24,377	29,350	41,931
Other natural resources	1,856	3,463	3,646	5,034
Total revenues	$57,430	$83,013	$105,235	$167,618
Segment earnings (loss):				
Real estate	$15,527	$27,297	$24,593	$50,872
Oil and gas	(56,867)	9,522	(59,808)	10,329
Other natural resources	(43)	2,079	(434)	1,551
Total segment earnings (loss)	(41,383)	38,898	(35,649)	62,752
Items not allocated to segments:				
General and administrative expense	(5,177)	(5,566)	(11,197)	(10,734)
Share-based and long-term incentive compensation expense	(23)	(3,219)	(3,481)	(3,532)
Interest expense	(8,715)	(7,370)	(17,536)	(12,873)
Other corporate non-operating income	47	130	95	252
Income (loss) before taxes	(55,251)	22,873	(67,768)	35,865
Income tax benefit (expense)	20,744	(8,051)	25,103	(12,709)
Net income (loss) attributable to Forestar Group Inc.	$(34,507)	$14,822	$(42,665)	$23,156

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Significant aspects of our results of operations follow:

Second Quarter and First Six Months 2015

- Second quarter and first six months 2015 real estate segment earnings declined principally due to a $10,476,000 gain in second quarter 2014 associated with a non-monetary exchange of leasehold timber rights for 5,400 acres of undeveloped land with a partner in a consolidated venture, lower undeveloped land sales and decreased residential lot sales activity.
- Oil and gas segment results decreased in second quarter and first six months 2015 principally due to $56,529,000 of non-cash impairment charges, which include $25,035,000 for proved oil and gas properties, $20,903,000 for unproved leasehold interests principally in Oklahoma, Nebraska and Kansas, and exploratory dry hole and pre-drilling costs of $10,591,000 related to non-core oil and gas properties in Oklahoma. In addition, segment earnings were negatively impacted by lower realized oil and gas prices despite an increase in production volumes and lower operating costs when compared with the same period in 2014. First six months 2015 results also include a lease termination penalty of $1,750,000 associated with the closure of our office in Fort Worth, Texas and $1,574,000 of employee severance and retention bonus costs as part of our initiative to significantly reduce oil and gas operating costs.
- Share-based and long-term incentive compensation expense decreased principally as result of a 15 percent decrease in our stock price since year-end 2014, compared with a ten percent decrease in our stock price in first six months 2014 since year-end 2013, which impacted the value of vested cash-settled awards.
- Second quarter and first six months 2015 interest expense increased primarily due to higher average borrowing rates and increased debt outstanding.

Second Quarter and First Six Months 2014

- Second quarter and first six months 2014 real estate segment earnings benefited from increased undeveloped land sales and residential lot sales activity. In addition, second quarter 2014 real estate segment earnings included a $10,476,000 gain associated with a non-monetary exchange of leasehold timber rights for 5,400 acres of undeveloped land with a partner in a consolidated venture.
- Oil and gas segment earnings increased principally due to gain of $5,706,000 related to the sale of oil and gas properties in Oklahoma and North Dakota. Segment earnings also benefited from higher working interest production volumes compared with second quarter and first six months 2013, offset partially by higher exploration, production and operating expenses. In addition, segment earnings were negatively impacted by lower production volumes and delay rental revenues associated with our owned mineral interests.
- Second quarter 2014 other natural resources segment earnings increased compared with second quarter 2013 principally due to a groundwater reservation agreement which generated $698,000 in segment earnings and a $685,000 gain from a partial termination of a timber lease. Second quarter and first six months 2014 segment earnings were impacted by lower fiber volumes compared with second quarter and first six months 2013.
- Share-based compensation expense decreased principally as result of a ten percent decrease in our stock price since year-end 2013, compared with a 16 percent increase in our stock price in first six months 2013 since year-end 2012, which impacted the value of vested cash-settled awards.
- Second quarter and first six months 2014 interest expense increased primarily due to higher average borrowing rates and debt outstanding.

Current Market Conditions

Sales of new U.S. single-family homes were 482,000 units in June 2015, on an annualized basis, up 18 percent compared with June 2014, but down almost seven percent compared with the downwardly-revised May 2015 results, indicating the housing recovery remains tentative. Inventories of new homes are at below historical levels in many areas. In addition, declining finished lot inventories and supply of economically developable raw land has resulted in demand for our developed lots. However, national and global economic weakness and uncertainty, and a restrictive mortgage lending environment continue to threaten a robust recovery in the housing market, despite low interest rates. Multifamily market conditions continue to be strong, with many markets experiencing healthy occupancy levels and positive rent growth. This improvement has been driven primarily by limited housing inventory, reduced single-family mortgage credit availability, and the increased propensity to rent among the 18 to 34 year old demographic of the U.S.

population

West Texas Intermediate crude oil prices at the end of second quarter 2015 have declined over 40 percent compared with second quarter 2014, driven by a combination of lower worldwide economic growth, record inventory levels and concern over higher oil exports from Iran. In response to the significant decline in crude oil prices, exploration and development activity in

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the U.S. has declined sharply, however production has remained at historically high levels, aided by increased drilling efficiencies and lower costs. U.S. production continues to be liquids focused principally due to the premium price of oil over gas when comparing energy equivalency and current estimates of domestic gas producing supplies are believed to be sufficient.

Henry Hub natural gas prices at the end of second quarter 2015 were down approximately 37 percent compared with second quarter 2014, and remain significantly lower than realized prices over the last decade. The decline in natural gas prices is principally driven by higher inventories, which are 35 percent higher than year ago levels, and modestly above the previous five year average. Despite low prices, natural gas production in the U.S. remains high, driven by continued improvements in drilling efficiency and lower operating costs, which is expected to result in additional inventory growth.

Business Segments

We manage our operations through three business segments:

- Real estate,
- Oil and gas, and
- Other natural resources.

We evaluate performance based on segment earnings (loss) before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures, gain on sales of assets, interest income on loans secured by real estate and net (income) loss attributable to noncontrolling interests. Items not allocated to our business segments consist of general and administrative expense, share-based and long-term incentive compensation, gain on sale of strategic timberland, interest expense and other corporate non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements.

We operate in cyclical industries. Our operations are affected to varying degrees by supply and demand factors and economic conditions including changes in interest rates, availability of mortgage credit, consumer and home builder sentiment, new housing starts, real estate values, employment levels, changes in the market prices for oil, gas and timber, and the overall strength or weakness of the U.S. economy.

Real Estate

We own directly or through ventures approximately 111,000 acres of real estate located in 11 states and 14 markets. Our real estate segment secures entitlements and develops infrastructure on our lands, primarily for single-family residential and mixed-use communities. We own approximately 87,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We target investments principally in our strategic growth corridors, regions across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment. We own and manage our projects either directly or through ventures. Our real estate segment revenues are principally derived from the sales of residential single-family lots and tracts, undeveloped land and commercial real estate, and from the operation of income producing properties, primarily a hotel and multifamily properties.

A summary of our real estate results follows:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Revenues	$39,409	$55,173	$72,239	$120,653
Cost of sales	(21,438)	(32,025)	(39,492)	(68,209)
Operating expenses	(9,674)	(9,315)	(19,276)	(17,390)
	8,297	13,833	13,471	35,054
Interest income	736	2,139	1,605	4,311
Gain on sale of assets	1,160	10,476	1,160	10,476
Equity in earnings of unconsolidated ventures	5,523	775	8,467	1,630
Less: Net (income) loss attributable to noncontrolling interests	(189)	74	(110)	(599)

Segment earnings	$15,527	$27,297	$24,593	$50,872

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Revenues in our owned and consolidated ventures consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Residential real estate	$23,820	$33,901	$42,142	$69,162
Commercial real estate	1,477	609	2,854	780
Undeveloped land	2,750	7,297	4,765	27,010
Commercial and income producing properties	11,109	11,050	21,978	20,983
Other	253	2,316	500	2,718
	$39,409	$55,173	$72,239	$120,653

Residential real estate revenues principally consist of the sale of single-family lots to local, regional and national homebuilders. Revenues decreased in first six months 2015 compared with first six months 2014 primarily due to lower residential lot sales and reduced undeveloped land sales. In addition, in first six months 2015, we sold 783 acres of residential tract for $4,035,000 which generated segment earnings of $1,275,000, compared to 910 acres of residential tract for $6,567,000 which generated segment earnings of $2,698,000 in first six months 2014.

In first six months 2015, we sold 1,634 acres of undeveloped land for $4,765,000, or approximately $2,916 per acre, generating approximately $3,468,000 in segment earnings, as compared with 12,279 acres sold for $27,010,000 or approximately $2,200 per acre, generating approximately $20,667,000 in segment earnings in first six months 2014.

Commercial and income producing properties revenue include revenues from hotel room sales and other guest services, rental revenues from our operating multifamily properties and our reimbursement for costs paid to subcontractors plus development and construction fees we may earn on certain multifamily projects. Second quarter and first six months 2015 include $2,525,000 and $4,554,000 in construction revenues associated with our multifamily fixed fee contract as general contractor. Revenues associated with multifamily construction contracts for second quarter and first six months 2014 were $3,461,000 and $6,694,000. Rental revenues from our multifamily operating properties for second quarter and first six months 2015 were $2,041,000 and $3,803,000 compared with no rental revenues in first six months 2014, primarily due to the substantial completion of the Eleven multifamily project at the end of second quarter 2014 and acquiring our partner's interest in Eleven multifamily venture in third quarter 2014. In addition, our Midtown Cedar Hill multifamily project near Dallas was substantially completed in second quarter 2015 and is 77 percent occupied at second quarter-end 2015.

Units sold consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
Owned and consolidated ventures:				
Residential lots sold	271	481	513	1,317
Revenue per lot sold	$71,465	$60,651	$72,219	$47,644
Commercial acres sold	20	3	24	3
Revenue per commercial acre sold	$73,345	$96,774	$117,014	$96,774
Undeveloped acres sold	903	2,950	1,634	12,279
Revenue per acre sold	$3,044	$2,473	$2,916	$2,200
Ventures accounted for using the equity method:				
Residential lots sold	248	56	295	194
Revenue per lot sold	$75,543	$93,306	$78,253	$67,772
Commercial acres sold	1	—	30	—
Revenue per commercial acre sold	$303,734	$—	$311,995	$—
Undeveloped acres sold	345	258	345	258
Revenue per acre sold	$2,983	$2,306	$2,983	$2,306

Cost of sales in second quarter and first six months 2015 include $2,692,000 and $5,126,000 related to multifamily construction contract costs we incurred as general contractor and paid to subcontractors associated with our development of a multifamily venture property near Denver, compared with $3,539,000 and $9,041,000 associated with two multifamily venture properties in second quarter and first six months 2014, of which one of was completed in second quarter 2014. Included in multifamily construction contract costs are charges of $167,000 and $572,000 in second quarter and first six months 2015 reflecting estimated cost increases associated with our fixed fee contracts as general contractor for one multifamily venture

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property compared with charges of $78,000 and $2,347,000 associated with two multifamily venture properties in second quarter and first six months 2014. Cost of sales in first six months 2015 also includes $729,000 of non-cash asset impairment charges, of which $504,000 was recognized in first quarter 2015 associated with a residential development with golf course and country club property located near Fort Worth, which was sold in April 2015, and $225,000 was recognized in second quarter 2015 related to one owned project near Atlanta.

Operating expenses consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Employee compensation and benefits	$2,027	$2,655	$4,326	$5,513
Property taxes	2,723	1,899	4,837	3,485
Professional services	1,856	2,272	2,536	3,411
Depreciation and amortization	2,005	695	3,729	1,343
Other	1,063	1,794	3,848	3,638
	$9,674	$9,315	$19,276	$17,390

The increase in operating expenses for second quarter and first six months 2015 is principally related to increase in depreciation and amortization and property taxes associated with the Eleven multifamily project which was completed in second quarter 2014 and Midtown Cedar Hill multifamily project which is substantially complete. In third quarter 2014, we acquired full ownership of the Eleven multifamily project in Austin in which we previously held a 25 percent equity interest.

Interest income principally represents earnings from a loan secured by a mixed-use real estate community in Houston that was paid in full in first quarter 2015 and interest income received on reimbursements from utility and improvement districts.

In second quarter 2015, we recorded a gain of $1,160,000 associated with the reduction of a surety bond in connection with the Cibolo Canyons Special Improvement District bond offering in 2014. In second quarter 2014, the $10,476,000 gain is associated with a non-monetary exchange of leasehold timber rights on approximately 10,300 acres for 5,400 acres of undeveloped land with a partner in a consolidated venture.

Increase in equity earnings from our unconsolidated ventures in first six months 2015 is primarily related to increased lot sales activity associated with two ventures in Houston, Texas.

Net income attributable to noncontrolling interests in first six months 2015 declined as compared with the prior year principally due to the purchase of noncontrolling interests in the Lantana ventures for $7,971,000 in March 2014.

Information about our real estate projects and our real estate ventures follows:

	Second Quarter-End	
	2015	2014
Owned and consolidated ventures:		
Entitled, developed and under development projects		
Number of projects	68	65
Residential lots remaining	15,009	15,077
Commercial acres remaining	1,733	1,718
Undeveloped land and land in the entitlement process		
Number of projects	11	11
Acres in entitlement process	24,430	24,430
Acres undeveloped	71,044	79,563
Ventures accounted for using the equity method:		
Ventures' entitled, developed and under development projects		
Number of projects	8	8
Residential lots remaining	2,594	3,021
Commercial acres remaining	182	240

Ventures' undeveloped land and land in the entitlement process		
Acres undeveloped	4,358	5,073

We underwrite development projects based on a variety of assumptions incorporated into our development plans, including the timing and pricing of sales and leasing and costs to complete development. Our development plans are

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periodically reviewed in comparison to our return projections and expectations, and we may revise our plans as business conditions warrant. If as a result of changes to our development plans the anticipated future net cash flows are reduced such that our basis in a project is not fully recoverable, we may be required to recognize a non-cash impairment charge for such project.

Our net investment in owned and consolidated real estate by geographic location follows:

State	Entitled, Developed, and Under Development Projects	Undeveloped Land and Land in Entitlement Process	Commercial and Income Producing Properties	Total
	(In thousands)			
Texas	$252,382	$5,768	$141,196	$399,346
Georgia	14,537	62,953	—	77,490
California	8,915	23,783	—	32,698
North Carolina	12,299	40	15,870	28,209
Colorado	24,603	256	—	24,859
Tennessee	15,417	63	8,265	23,745
Other	17,028	150	—	17,178
	$345,181	$93,013	$165,331	$603,525

Oil and Gas

Our oil and gas segment is focused on the exploration, development and production of oil and gas on our mineral and leasehold interests.

We lease portions of our 590,000 owned net mineral acres located principally in Texas, Louisiana, Georgia and Alabama to other oil and gas companies in return for a lease bonus, delay rentals and a royalty interest. At second quarter-end 2015, we have about 21,000 net acres leased to others, about 36,000 net acres leased to others that are held by production and 528 gross productive wells operated by others on our owned mineral acres. Most leases are for a three to five year term although all or a portion of a lease may be extended as long as actual production is occurring.

At second quarter-end 2015, our leasehold interests include 345,000 net mineral acres leased from others principally located in Nebraska and Kansas primarily targeting the Lansing-Kansas City formation, in Oklahoma targeting various formations in the Anadarko Basin, in the Texas Panhandle primarily targeting the Tonkawa and Cleveland formations and in North Dakota primarily targeting the Bakken and Three Forks formations. Our leasehold interests include 9,000 net mineral acres in the Bakken and Three Forks formation. We have 47,000 net acres of leasehold interests held by production and 414 gross oil and gas wells with working interest ownership, of which 151 are operated by us.

A summary of our oil and gas results follows:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Revenues	$16,165	$24,377	$29,350	$41,931
Cost of oil and gas producing activities	(70,141)	(16,926)	(81,683)	(29,546)
Operating expenses	(2,626)	(3,812)	(8,482)	(8,071)
	(56,602)	3,639	(60,815)	4,314
Gain (loss) on sale of assets	(322)	5,706	854	5,706
Equity in earnings of unconsolidated ventures	57	177	153	309
Segment earnings (loss)	$(56,867)	$9,522	$(59,808)	$10,329

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Revenues consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Oil production [(a)]	$14,458	$22,010	$25,762	$37,004
Gas production	1,388	1,840	2,904	3,781
Other (principally lease bonus and delay rentals)	319	527	684	1,146
	$16,165	$24,377	$29,350	$41,931

(a) Oil production includes revenues from oil, condensate and natural gas liquids (NGLs).

In second quarter and first six months 2015, oil and gas production revenues decreased principally as a result of lower oil and gas prices despite an increase in oil and gas production volumes as compared with the same period in 2014. The decline in oil prices negatively impacted revenues by $12,362,000 and $26,927,000 in second quarter and first six months 2015 as compared with the previous year. This decline was partially offset by a $4,807,000 and $15,685,000 increase in revenues as a result of higher oil production volumes in second quarter and first six months 2015, respectively. The decline in gas prices negatively impacted revenues by $940,000 and $1,566,000 in second quarter and first six months 2015, partially offset by a $492,000 and $689,000 increase in revenues as a result of increased gas production volumes in second quarter and first six months 2015, as compared with the previous year.

Other revenues include $482,000 in lease bonuses received from leasing 1,600 net mineral acres owned in Texas and Louisiana during the first six months 2015 as compared with $1,084,000 in lease bonuses received from leasing approximately 3,100 net mineral acres owned in Texas and Louisiana during the same period in 2014.

Cost of oil and gas producing activities consists of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Depletion and amortization	$7,679	$7,213	$14,883	$11,809
Production costs	5,289	4,457	9,391	8,305
Exploration costs	10,126	4,599	10,294	7,979
Impairment of proved properties and unproved leasehold interests	45,938	584	45,945	1,339
Other	1,109	73	1,170	114
	$70,141	$16,926	$81,683	$29,546

Cost of oil and gas producing activities increased in second quarter and first six months 2015 principally as a result of non-cash impairment charges of $25,035,000 for proved oil and gas properties, $20,903,000 for unproved leasehold interests principally in Oklahoma, Nebraska and Kansas and exploratory dry hole and pre-drilling costs of $10,591,000 related to non-core oil and gas properties in Oklahoma. In second quarter and first six months 2015, cost of oil and gas producing activities were also affected by an increase in depletion expenses due to higher oil and gas production volumes, as compared to the same period during 2014. Depletion and amortization represent the non-cash cost of producing oil and gas associated with our working interests and is computed based on the units of production method.

Exploration costs principally represent exploratory dry hole costs, geological and geophysical and seismic study costs. Dry hole costs in first six months 2015 were $9,752,000, which includes a $9,674,000 charge in second quarter 2015 primarily associated with an exploratory well in Oklahoma. Dry hole costs in first six months 2014 were $5,665,000, which includes a $2,141,000 charge in second quarter 2014 associated with an exploratory well in east Texas. As a result of expiring leasehold interests, we recorded non-cash impairment charges on our unproved oil and gas properties of $1,339,000 in first six months 2014.

Production costs principally represent lease operating expenses associated with producing working interest wells and our share of production severance taxes related to both our royalty and working interests.

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Oil and gas produced and average unit prices related to our royalty and working interests follows:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
Consolidated entities:				
Oil production (barrels)	262,000	225,300	531,900	382,300
Average oil price per barrel	$53.37	$95.38	$46.68	$93.75
NGL production (barrels)	27,200	12,000	50,900	27,000
Average NGL price per barrel	$17.54	$43.24	$18.35	$43.17
Total oil production (barrels), including NGLs	289,200	237,300	582,800	409,300
Average total oil price per barrel, including NGLs	$50.00	$92.75	$44.20	$90.41
Gas production (millions of cubic feet)	518.9	409.4	997.0	843.2
Average price per thousand cubic feet	$2.68	$4.49	$2.91	$4.48
Our share of ventures accounted for using the equity method:				
Gas production (millions of cubic feet)	40.1	50.5	82.4	103.2
Average price per thousand cubic feet	$2.37	$4.54	$2.85	$4.01
Total consolidated and our share of equity method ventures:				
Oil production (barrels)	262,000	225,300	531,900	382,300
Average oil price per barrel	$53.37	$95.38	$46.68	$93.75
NGL production (barrels)	27,200	12,000	50,900	27,000
Average NGL price per barrel	$17.54	$43.24	$18.35	$43.17
Total oil production (barrels), including NGLs	289,200	237,300	582,800	409,300
Average total oil price per barrel, including NGLs	$50.00	$92.75	$44.20	$90.41
Gas production (millions of cubic feet)	559.0	459.9	1,079.4	946.4
Average price per thousand cubic feet	$2.65	$4.50	$2.91	$4.43
Total BOE (barrel of oil equivalent) [a]	382,300	313,900	762,700	567,000
Average price per barrel of oil equivalent	$41.70	$76.70	$37.89	$72.66

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[a] Gas is converted to barrels of oil equivalent (BOE) using a conversion of six Mcf to one barrel of oil.

Operating expenses consist of:

	Second Quarter		First Six Months	
	2015	2014	2015	2014
	(In thousands)			
Employee compensation and benefits	$1,433	$2,443	$4,054	$5,014
Professional and consulting services	465	288	1,172	677
Depreciation	271	264	482	515
Other	457	817	2,774	1,865
	$			