M I HOMES INC
Form 10-Q
October 26, 2010

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 September 30, 2010

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES ACT OF 1934

Commission File Number 1-12434

M/I HOMES, INC.
(Exact name of registrant as specified in it charter)

Ohio	31-1210837
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3 Easton Oval, Suite 500, Columbus, Ohio 43219
(Address of principal executive offices) (Zip Code)
(614) 418-8000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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 No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
Common shares, par value $.01 per share: 18,523,335 shares outstanding as of October 21, 2010.

M/I HOMES, INC.
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M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par values)	September 30, 2010 (Unaudited)	December 31, 2009
ASSETS:		
Cash	$43,894	$109,930
Restricted cash	48,108	22,302
Mortgage loans held for sale	32,446	34,978
Inventory	487,986	420,289
Property and equipment - net	17,453	18,998
Investment in unconsolidated limited liability companies	11,102	10,299
Income tax receivable	4,298	30,135
Other assets	11,937	16,897
TOTAL ASSETS	$657,224	$663,828
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable	$53,863	$38,262
Customer deposits	4,420	3,831
Other liabilities	48,331	56,426
Community development district obligations	7,406	8,204
Obligation for consolidated inventory not owned	—	616
Note payable bank - financial services operations	23,773	24,142
Note payable — other	5,932	6,160
Senior notes — net of discount of $384 and $576, respectively, at September 30, 2010 and December 31, 2009	199,616	199,424
TOTAL LIABILITIES	343,341	337,065
Commitments and contingencies	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares — $.01 par value; authorized 2,000,000 shares; issued 4,000 shares	96,325	96,325
Common shares — $.01 par value; authorized 38,000,000 shares; issued 22,101,723 shares at September 30, 2010 and December 31, 2009	221	221
Additional paid-in capital	139,772	137,492
Retained earnings	148,635	163,847
Treasury shares — at cost — 3,578,388 and 3,580,987 shares, respectively, at September 30, 2010 and December 31, 2009	(71,070)	(71,122)
TOTAL SHAREHOLDERS' EQUITY	313,883	326,763
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$657,224	$663,828

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
(In thousands, except per share amounts)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue	$135,609	$152,738	$451,402	$365,033
Costs, expenses and other loss:				
Land and housing	108,659	131,416	373,030	320,929
Impairment of inventory and investment in unconsolidated limited liability companies	1,796	14,962	11,206	32,484
General and administrative	13,148	14,414	39,601	42,831
Selling	11,735	11,601	36,482	30,339
Interest	1,952	1,298	6,172	6,305
Other loss	—	—	—	941
Total costs, expenses and other loss	137,290	173,691	466,491	433,829
Loss before income taxes	(1,681)	(20,953)	(15,089)	(68,796)
Provision for income taxes	389	121	123	309
Net loss	$(2,070)	$(21,074)	$(15,212)	$(69,105)
Loss per common share:				
Basic	$(0.11)	$(1.14)	$(0.82)	$(4.29)
Diluted	$(0.11)	$(1.14)	$(0.82)	$(4.29)
Weighted average shares outstanding:				
Basic	18,523	18,514	18,523	16,127
Diluted	18,523	18,514	18,523	16,127

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Nine Months Ended September 30, 2010 (Unaudited)							
	Preferred Shares		Common Shares		Additional			Total
	Shares		Shares		Paid-in	Retained	Treasury	Shareholders'
(Dollars in thousands)	Outstanding	Amount	Outstanding	Amount	Capital	Earnings	Shares	Equity
Balance at December 31, 2009	4,000	$96,325	18,520,736	$221	$137,492	$163,847	$(71,122)	$ 326,763
Net loss	—	—	—	—	—	(15,212)	—	(15,212)
Income tax benefit from stock options and deferred compensation distributions	—	—	—	—	(14)	—	—	(14)
Stock options exercised	—	—	600	—	(7)	—	12	5
Stock-based compensation expense	—	—	—	—	2,179	—	—	2,179
Deferral of executive and director compensation	—	—	—	—	162	—	—	162
Executive and director deferred compensation distributions	—	—	1,999	—	(40)	—	40	—
Balance at September 30, 2010	4,000	$96,325	18,523,335	$221	$139,772	$148,635	$(71,070)	$ 313,883

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2010	2009
(In thousands)	(Unaudited)	(Unaudited)
OPERATING ACTIVITIES:		
Net loss	$(15,212)	$(69,105)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Inventory valuation adjustments and abandoned land transaction write-offs	11,603	27,076
Impairment of investment in unconsolidated limited liability companies	—	6,896
Mortgage loan originations	(301,419)	(275,655)
Proceeds from the sale of mortgage loans	305,430	275,748
Fair value adjustment of mortgage loans held for sale	(1,479)	592
Net loss from property disposals	7	942
Bad debt expense	—	1,223
Depreciation	3,859	3,887
Amortization of intangibles, debt discount and debt issue costs	1,935	1,901
Stock-based compensation expense	2,179	2,337
Deferred income tax benefit	(5,684)	(27,532)
Deferred tax asset valuation allowance	5,684	27,532
Income tax receivable	25,837	39,456
Excess tax expense from stock-based payment arrangements	14	103
Equity in undistributed income of unconsolidated limited liability companies	(155)	(10)
Write-off of unamortized debt discount and financing costs	311	554
Change in assets and liabilities:		
Cash held in escrow	(9,358)	(4,278)
Inventory	(81,562)	(12,891)
Other assets	6,780	2,205
Accounts payable	15,601	22,922
Customer deposits	589	2,145
Accrued compensation	(1,141)	(3,682)
Other liabilities	(6,806)	2,651
Net cash (used in) provided by operating activities	(42,987)	25,017
INVESTING ACTIVITIES:		
Restricted cash	(16,448)	(66,858)
Purchase of property and equipment	(1,455)	(3,695)
Proceeds from the sale of property	—	7,878
Investment in unconsolidated limited liability companies	(661)	(1,068)
Return of investment from unconsolidated limited liability companies	13	61
Net cash used in investing activities	(18,551)	(63,682)
FINANCING ACTIVITIES:		
Repayments of bank borrowings - net	(369)	(8,456)
Principal repayments of note payable-other and community development district bond obligations	(246)	(10,710)

Net proceeds from the issuance of common stock	—	52,568
Debt issue costs	(3,874)	(2,122)
Payments on capital lease obligations	—	(91)
Proceeds from exercise of stock options	5	61
Excess tax benefit from stock-based payment arrangements	(14)	(103)
Net cash (used in) provided by financing activities	(4,498)	31,147
Net decrease in cash	(66,036)	(7,518)
Cash balance at beginning of period	109,930	32,518
Cash balance at end of period	$43,894	$25,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest — net of amount capitalized	$372	$662
Income taxes	$274	$168
NON-CASH TRANSACTIONS DURING THE YEAR:		
Community development district infrastructure	$(780)	$(1,362)
Consolidated inventory not owned	$(616)	$(4,826)
Distribution of single-family lots from unconsolidated limited liability companies	$—	$2
Deferral of executive and director compensation	$162	$138
Executive and director deferred compensation distributions	$40	$211

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements (the “financial statements”) of M/I Homes, Inc. and its subsidiaries (the “Company”) and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission for interim financial information. The financial statements include the accounts of M/I Homes, Inc. and its subsidiaries. All intercompany transactions have been eliminated. Results for the interim period are not necessarily indicative of results for a full year. In the opinion of management, the accompanying financial statements reflect all adjustments (all of which are normal and recurring in nature) necessary for a fair presentation of financial results for the interim periods presented. These financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 (the “2009 Form 10-K”).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during that period. Actual results could differ from these estimates and have a significant impact on the financial condition and results of operations and cash flows. With regard to the Company, estimates and assumptions are inherent in calculations relating to valuation of inventory and investment in unconsolidated limited liability companies (“Unconsolidated LLCs”), property and equipment depreciation, valuation of derivative financial instruments, accounts payable on inventory, accruals for costs to complete inventory, accruals for warranty claims, accruals for self-insured general liability claims, litigation, accruals for health care and workers' compensation, accruals for guaranteed or indemnified loans, stock-based compensation expense, income taxes, and contingencies. Items that could have a significant impact on these estimates and assumptions include the risks and uncertainties listed in “Item 1A. Risk Factors” in Part I of our 2009 Form 10-K, as the same may be updated from time to time in our subsequent filings with the Securities and Exchange Commission.

NOTE 2. Cash and Restricted Cash

The table below is a summary of our cash balances at September 30, 2010 and December 31, 2009:

(In thousands)	September 30, 2010	December 31, 2009
Homebuilding	$29,700	$96,464
Financial services	14,194	13,466
Unrestricted cash	$43,894	$109,930
Restricted cash	48,108	22,302
Total cash	$92,002	$132,232

Restricted cash primarily consists of homebuilding cash the Company had designated as collateral at September 30, 2010 and December 31, 2009 in accordance with the four secured Letter of Credit Facilities that were entered into in July 2009 and the one secured Letter of Credit Facility entered into in June 2010 (collectively, as amended, the “Letter of Credit Facilities”). Restricted cash also includes cash held in escrow of $12.5 million and $3.1 million at September 30, 2010 and December 31, 2009, respectively.

NOTE 3. Impact of New Accounting Standards

In January 2010, the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) — Improving Disclosures about Fair Value Measurements (“ASU 2010-06”), which amends Accounting Standards Codification 820 to require the disclosure of additional information related to fair value measurement and provide clarification to existing requirements for fair value measurement disclosure. ASU 2010-06 was effective for the Company beginning January 1, 2010. The Company's disclosures conform to the requirements of ASU 2010-06. Refer to Note 4 for additional discussion of fair value measurements.

NOTE 4. Fair Value Measurements

There are three measurement input levels for determining fair value: Level 1, Level 2, and Level 3. Fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

Assets Measured on a Recurring Basis

The Company measures both mortgage loans held for sale and interest rate lock commitments ("IRLCs") at fair value. Fair value measurement results in a better offset of the changes in fair values of the loans and the derivative instruments used to economically hedge them.

In the normal course of business, our financial services segment enters into contractual commitments to extend credit to buyers of single-family homes with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within established time frames. Market risk arises if interest rates move adversely between the time of the "lock-in" of rates by the borrower and the sale date of the loan to an investor. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into optional or mandatory delivery forward sale contracts to sell whole loans and mortgage-backed securities to broker/dealers. The forward sale contracts lock in an interest rate and price for the sale of loans similar to the specific rate lock commitments. The Company does not engage in speculative or trading derivative activities. Both the rate lock commitments to borrowers and the forward sale contracts to broker/dealers or investors are undesignated derivatives, and accordingly, are marked to fair value through earnings. Changes in fair value measurements are included in earnings in the accompanying Unaudited Condensed Consolidated Statements of Operations.

The fair value is based on published prices for mortgage-backed securities with similar characteristics, and the buyup fees received or buydown fees to be paid upon securitization of the loan. The buyup and buydown fees are calculated pursuant to contractual terms with investors. To calculate the effects of interest rate movements, the Company utilizes applicable published mortgage-backed security prices, and multiplies the price movement between the rate lock date and the balance sheet date by the notional loan commitment amount. The Company sells the majority of its loans on a servicing released basis, and receives a servicing release premium upon sale. Thus, the value of the servicing rights included in the fair value measurement is based upon contractual terms with investors and depends on the loan type. The Company applies a fallout rate to IRLCs when measuring the fair value of rate lock commitments. Fallout is defined as locked loan commitments for which the Company does not close a mortgage loan and is based on management's judgment and historical experience.

The fair value of the Company's forward sales contracts to broker/dealers solely considers the market price movement of the same type of security between the trade date and the balance sheet date. The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

Mortgage loans held for sale are closed at cost, which includes all fair value measurements.

Loan Commitments. IRLCs are extended to certain home-buying customers who have applied for a mortgage loan and meet certain defined credit and underwriting criteria. Typically, the IRLCs will have a duration of less than six months; however, in certain markets, the duration could extend to twelve months.

Some IRLCs are committed to a specific third-party investor through the use of best-efforts whole loan delivery commitments matching the exact terms of the IRLC loan. The notional amount of the committed IRLCs and the best-efforts contracts was $3.6 million at September 30, 2010. At September 30, 2010, the fair value of the committed IRLCs resulted in an asset of less than $0.1 million and the related best-efforts contracts resulted in a liability of less than $0.1 million. For the three and nine months ended September 30, 2010, we recognized income of less than $0.1 million and $0.1 million, respectively, relating to marking these committed IRLCs and the related best-efforts contracts to market.

Uncommitted IRLCs are considered derivative instruments and are fair value adjusted, with the resulting gain or loss recorded in current earnings. At September 30, 2010, the notional amount of the uncommitted IRLCs was $43.4 million. The fair value adjustment related to these uncommitted IRLCs, which is based on quoted market prices, resulted in an asset of $0.3 million at September 30, 2010. For the three and nine months ended September 30, 2010, we recognized expense of $0.4 million and income of $0.3 million, respectively, relating to marking the uncommitted IRLCs to market.

Forward Sales of Mortgage-Backed Securities. Forward sales of mortgage-backed securities (“FMBSs”) are used to protect uncommitted IRLC loans against the risk of changes in interest rates between the lock date and the funding date. FMBSs related to uncommitted IRLCs are classified and accounted for as non-designated derivative instruments and are recorded at fair value, with gains and losses recorded in current earnings. At September 30, 2010, the notional amount under these FMBSs was $43.0 million, and the related fair value adjustment, which is based on quoted market prices, resulted in an asset of $0.1 million. For the three and nine months ended September 30, 2010, we recognized income of $0.7 million and expense of $0.6 million, respectively, relating to marking these FMBSs to market.

Mortgage Loans Held for Sale: Mortgage loans held for sale consist primarily of single-family residential loans collateralized by the underlying property. During the intervening period between when a loan is closed and when it is sold to an investor, the interest rate risk is covered through the use of a best-efforts contract or by FMBSs.

The notional amount of the best-efforts contracts and related mortgage loans held for sale was $4.1 million at September 30, 2010. The fair value of the best-efforts contracts and related mortgage loans held for sale resulted in a net liability of $0.1 million at September 30, 2010. For the three and nine months ended September 30, 2010, we recognized income of less than $0.1 million and $0.7 million, respectively, relating to marking these best-efforts contracts and the related mortgage loans held for sale to market.

The notional amounts of both the FMBSs and the related mortgage loans held for sale were $28.0 million at September 30, 2010. The FMBSs are classified and accounted for as non-designated derivative instruments, with gains and losses recorded in current earnings. As of September 30, 2010, the related fair value adjustment for marking these FMBSs to market resulted in a liability of $0.1 million. For the three and nine months ended September 30, 2010, we recognized income of $1.3 million and expense of $0.2 million, respectively, relating to marking these FMBSs to market.

The table below shows the level and measurement of assets and liabilities measured on a recurring basis at September 30, 2010:

Description of asset or liability (In thousands)	Fair Value Measurements September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage loans held for sale	$331	$—	$331	$—
Forward sales of mortgage-backed securities	5	—	5	—
Interest rate lock commitments	329	—	329	—
Best-efforts contracts	(81)	—	(81)	—
Total	$584	$—	$584	$—

Assets Measured on a Non-Recurring Basis

The Company assesses inventory for recoverability on a quarterly basis by reviewing for impairment whenever events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable. In conducting our quarterly review for indicators of impairment on a community level, we evaluate, among other things, the margins on homes that have been delivered, margins on sales contracts in backlog, projected margins with regard to future home sales over the life of the community, projected margins with regard to future land sales, and the value of the land itself. We pay particular attention to communities in which inventory is moving at a slower than anticipated absorption pace, and communities whose average sales price and/or margins are trending downward and are anticipated to continue to trend downward. From this review, we identify communities whose carrying values may exceed their undiscounted cash flows. We also evaluate communities where management intends to lower the sales price or offer incentives in order to improve absorptions even if the community's historical results do not indicate a potential for impairment. For those communities deemed to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the communities exceeds the fair value of the communities. In addition, due to the fact that the estimates and assumptions included in the Company's cash flow models are based upon historical results and projected trends, unexpected changes in market conditions may lead the Company to incur additional impairment charges in the future.

Our determination of fair value is based on projections and estimates, which are Level 3 measurement inputs. Our analysis is completed at a phase level within each community; therefore, changes in local conditions may affect one or several of our communities. For all of the categories discussed below, the key assumptions relating to the valuations are dependent on project-specific local market and/or community conditions and are inherently uncertain.

Because each inventory asset is unique, there are numerous inputs and assumptions used in our valuation techniques. Local market-specific factors that may impact these projected assumptions include:

- historical project results such as average sales price and sales pace, if closings have occurred in the project;
- competitors' local market and/or community presence and their competitive actions;
- project specific attributes such as location desirability and uniqueness of product offering;
- potential for alternative product offerings to respond to local market conditions;
- current local market economic and demographic conditions and related trends and forecasts; and
- community-specific strategies regarding speculative homes.

These, and other local market-specific factors that may impact project assumptions discussed above, are considered by personnel in our homebuilding divisions as they prepare or update the forecasted assumptions for each community. Quantitative and qualitative factors other than home sales prices could significantly impact the potential for future impairments. The sales objectives can differ between communities, even within a given sub-market. For example, facts and circumstances in a given community may lead us to price our homes with the objective of yielding a higher sales absorption pace, while facts and circumstances in another community may lead us to price our homes to minimize deterioration in our gross margins, although it may result in a slower sales absorption pace. Furthermore, the key assumptions included in our estimated future undiscounted cash flows may be interrelated. For example, a decrease in estimated base sales price or an increase in home sales incentives may result in a corresponding increase in sales absorption pace. Additionally, a decrease in the average sales price of homes to be sold and closed in future reporting periods for one community that has not been generating what management believes to be an adequate sales absorption pace may impact the estimated cash flow assumptions of a nearby community. Changes in our key assumptions, including estimated construction and development costs, absorption pace, selling strategies, or discount rates, could materially impact future cash flow and fair value estimates. As of September 30, 2010, we utilized discount rates ranging from 13% to 16% in determining the fair value of our inventory and investments in Unconsolidated LLCs.

Operating Communities: For existing operating communities, the recoverability of assets is measured on a quarterly basis by comparing the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets based on home sales. These estimated cash flows are developed based primarily on management's assumptions relating to the specific community. The significant assumptions used to evaluate the recoverability of assets include: the timing of development and/or marketing phases; projected sales price and sales pace of each existing or planned community; the estimated land development, home construction, and selling costs of the community; overall market supply and demand; the local market; and competitive conditions. Management reviews these assumptions on a quarterly basis. While we consider available information to determine what we believe to be our best estimates as of the end of a reporting period, these estimates are subject to change in future reporting periods as facts and circumstances change. These assumptions vary widely across different communities and geographic areas and are largely dependent on local market conditions. Some of the most critical assumptions in the Company's cash flow models are projected absorption pace for home sales, sales prices, and costs to build and deliver homes on a community by community basis.

In order to arrive at the assumed absorption pace for home sales included in the Company's cash flow models, the Company analyzes the historical absorption pace in the community as well as other communities in the geographic area. In addition, the Company analyzes internal and external market studies and trends, which generally include, but are not limited to, statistics on population demographics, unemployment rates, and availability of competing products in the geographic area where a community is located. When analyzing the Company's historical absorption pace for home sales and corresponding internal and external market studies, the Company places greater emphasis on more current metrics and trends such as the absorption pace realized in its most recent quarters, as well as forecasted population demographics, unemployment rates, and availability of competing products.

In order to determine the assumed sales prices included in its cash flow models, the Company analyzes the historical sales prices realized on homes it delivered in the community and other communities in the geographic area as well as the sales prices included in its current backlog for such communities. In addition, the Company analyzes internal and external market studies and trends, which generally include, but are not limited to, statistics on sales prices in neighboring communities and sales prices on similar products in non-neighboring communities in the geographic area where the community is located. When analyzing its historical sales prices and corresponding market studies, the Company places greater emphasis on more current metrics and trends. Ultimately, upon this analysis, the Company sets a current sales price for each house type in the community, using the aforementioned information, which it believes will achieve an acceptable gross margin and sales pace in the community. This price becomes the price published to the sales force for use in its sales efforts. The Company then uses the average of these “published” sales prices in its cash flow models.

In order to arrive at the Company's assumed costs to build and deliver homes, the Company generally assumes a cost structure reflecting contracts currently in place with its vendors and subcontractors adjusted for any anticipated cost reduction initiatives or increases in cost structure. With respect to overhead included in the cash flow models, the Company uses forecasted rates included in the Company's annual budget for the overall market area adjusted for actual experience that is materially different than budgeted rates.

Future Communities: For raw land, land under development, or lots that management anticipates will be utilized for future homebuilding activities, the recoverability of assets is measured by comparing the carrying amount of the assets to future undiscounted cash flows expected to be generated by the assets based on home sales, consistent with the evaluations performed for operating communities discussed above.

For raw land, land under development, or lots that management intends to market for sale to a third party, but that do not meet all of the criteria to be classified as land held for sale as discussed below, the recoverability of the assets is determined based on either the estimated net sales proceeds expected to be realized on the sale of the assets or the estimated fair value determined using cash flow valuation techniques.

If the Company has not yet determined whether raw land, land under development, or lots will be utilized for future homebuilding activities or marketed for sale to a third party, the Company assesses the recoverability of the inventory using a probability-weighted approach.

Land Held for Sale: Land held for sale includes land that meets all of the following six criteria: (1) management, having the authority to approve the action, commits to a plan to sell the asset; (2) the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; (3) an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated; (4) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year; (5) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (6) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The Company records land held for sale at the lower of its carrying value or fair value less costs to sell. In performing an impairment evaluation for land held for sale, management considers, among other things, prices for land in recent comparable sales transactions, market analysis and recent bona fide offers received from outside third parties, as well as actual contracts. If the estimated fair value less the costs to sell an asset is less than the current carrying value, the asset is written down to its estimated fair value less costs to sell.

Investment In Unconsolidated Limited Liability Companies: The Company evaluates its investment in Unconsolidated LLCs for potential impairment on a quarterly basis. If the fair value of the investment is less than the investment's carrying value and the Company has determined that the decline in value is other than temporary, the Company would write down the value of the investment to fair value. The determination of whether an investment's fair value is less than the carrying value requires management to make certain assumptions regarding the amount and timing of future contributions to the Unconsolidated LLC, the timing of distribution of lots to the Company from the Unconsolidated LLC, the projected fair value of the lots at the time of distribution to the Company, and the estimated proceeds from, and timing of, the sale of land or lots to third parties. In determining the fair value of investments in Unconsolidated LLCs, the Company evaluates the projected cash flows associated with each Unconsolidated LLC. As of September 30, 2010, the Company used a discount rate of 16% in determining the fair value of investments in Unconsolidated LLCs. In addition to the assumptions management must make to determine if the investment's fair value is less than the carrying value, management must also use judgment in determining whether the impairment is other than temporary. The factors management considers are: (1) the length of time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospects of the Company; and (3) the intent and ability of the Company to retain its investment in the Unconsolidated LLC for a period of time sufficient to allow for any anticipated recovery in market value. In situations where the investments are 100% equity financed by the partners, and the joint venture simply distributes lots to its partners, the Company evaluates “other than temporary” by preparing an undiscounted cash flow model as described above for operating communities. If such model results in positive value versus carrying value, and the fair value of the investment is less than the investment's carrying value, the Company determines that the impairment is temporary; otherwise, the Company determines that the impairment is other than temporary and impairs the investment. Because of the high degree of judgment involved in developing these assumptions, it is possible that the Company may determine the investment is not impaired in the current period but, due to passage of time or change in market conditions leading to changes in assumptions, impairment could occur.

The table below shows the level and measurement of assets and liabilities measured on a non-recurring basis at September 30, 2010:

Description of asset or liability (In thousands)	Fair Value Measurements September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Inventory	$3,786	$—	$—	$3,786
Total fair value measurements	$3,786	$—	$—	$3,786

NOTE 5. Risk Management and Derivatives

As described in Note 4 above, in the normal course of business, our financial services segment is exposed to interest rate risk, and the Company uses derivatives to help manage this risk.

To meet the financing needs of our home-buying customers, M/I Financial Corp., our wholly-owned subsidiary ("M/I Financial"), is party to IRLCs, which are extended to customers who have applied for a mortgage loan and meet certain defined credit and underwriting criteria. These IRLCs are considered derivative financial instruments. M/I Financial manages interest rate risk related to its IRLCs and mortgage loans held for sale through the use of FMBSs, use of best-efforts whole loan delivery commitments, and the occasional purchase of options on FMBSs in accordance with Company policy. These FMBSs, options on FMBSs, and IRLCs covered by FMBSs are considered non-designated derivatives.

Certain IRLCs and mortgage loans held for sale are committed to third party investors through the use of best-efforts whole loan delivery commitments. The IRLCs and related best-efforts whole loan delivery commitments, which generally are highly effective from an economic standpoint, are considered non-designated derivatives, and are accounted for at fair value, with gains or losses recorded in financial services revenue. Under the terms of these best-efforts whole loan delivery commitments covering mortgage loans held for sale, the specific committed mortgage loans held for sale are identified and matched to specific delivery commitments on a loan-by-loan basis. The delivery commitments and loans held for sale are recorded at fair value, with changes in fair value recorded in financial services revenue.

All derivatives are recognized on the balance sheet at their fair value. The total notional amount of the Company's derivatives as of September 30, 2010 and December 31, 2009 was $125.8 million and $126.1 million, respectively. Refer to Note 4 above for further discussion of our derivative instruments.

The following tables set forth the fair value of the Company's derivative instruments and their location within the Unaudited Condensed Consolidated Balance Sheets for the periods indicated:

	Asset Derivatives At September 30, 2010		Liability Derivatives At September 30, 2010	
Description of Derivatives	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	$5	Other liabilities	$—
Interest rate lock commitments	Other assets	329	Other liabilities	—
Best-efforts contracts	Other assets	—	Other liabilities	81

Total fair value measurements		$334		$81

Description of Derivatives	Asset Derivatives At December 31, 2009		Liability Derivatives At December 31, 2009	
	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	$833	Other liabilities	$—
Interest rate lock commitments	Other assets	—	Other liabilities	145
Best-efforts contracts	Other assets	308	Other liabilities	—
Total fair value measurements		$1,141		$145

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The following tables set forth the amount of gain (loss) recognized on our derivative instruments and their location in the Unaudited Condensed Consolidated Statements of Operations for the periods indicated:

Description of Derivatives	Three Months Ended September 30, 2010 (in thousands)	Nine Months Ended September 30, 2010 (in thousands)	Location of Gain (Loss) Recognized on Derivatives
Forward sales of mortgage-backed securities	$1,956	$(828)	Financial Services Revenue
Interest rate lock commitments	(373)	474	Financial Services Revenue
Best-efforts contracts	22	(389)	Financial Services Revenue
Total gain (loss) recognized on derivatives	$1,605	$(743)	

Description of Derivatives	Three Months Ended September 30, 2009 (in thousands)	Nine Months Ended September 30, 2009 (in thousands)	Location of Gain (Loss) Recognized on Derivatives
Forward sales of mortgage-backed securities	$(2,341)	$(230)	Financial Services Revenue
Interest rate lock commitments	1,240	382	Financial Services Revenue
Best-efforts contracts	(99)	(349)	Financial Services Revenue
Total loss recognized on derivatives	$(1,200)	$(197)	

NOTE 6. Inventory

A summary of the Company's inventory as of September 30, 2010 and December 31, 2009 is as follows:

(In thousands)	September 30, 2010	December 31, 2009
Single-family lots, land and land development costs	$258,657	$232,127
Land held for sale	—	4,300
Homes under construction	199,129	158,998
Model homes and furnishings - at cost (less accumulated depreciation: September 30, 2010 - $3,460; December 31, 2009 - $3,069)	20,802	14,726
Community development district infrastructure	7,406	8,186
Land purchase deposits	1,992	1,336
Consolidated inventory not owned	—	616
Total inventory	$487,986	$420,289

Single-family lots, land and land development costs include raw land that the Company has purchased to develop into lots, costs incurred to develop the raw land into lots, and lots for which development has been completed but which have not yet been used to start construction of a home.

Land held for sale includes land that meets the six criteria discussed above in Note 4. The Company records land held for sale at the lower of its carrying value or fair value less costs to sell.

Homes under construction include homes that are in various stages of construction. As of September 30, 2010 and December 31, 2009, we had 630 homes (with a carrying value of $77.0 million) and 545 homes (with a carrying value of $59.4 million), respectively, included in homes under construction that were not subject to a sales contract.

Model homes and furnishings include homes that are under construction or have been completed and are being used as sales models. The amount also includes the net book value of furnishings included in our model homes. Depreciation on model home furnishings is recorded using an accelerated method over the estimated useful life of the assets, typically three years.

The Company assesses inventory for recoverability on a quarterly basis, by reviewing for impairment whenever events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable. Refer to Note 4 and Note 7 for additional details relating to our procedures for evaluating our inventories for impairment.

Land purchase deposits include both refundable and non-refundable amounts paid to third party sellers relating to the purchase of land. On an ongoing basis, the Company evaluates the land option agreements relating to the land purchase deposits. In the period during which the Company makes the decision not to proceed with the purchase of land under an agreement, the Company writes off any deposits and accumulated pre-acquisition costs relating to such agreement. For the three and nine months ended

September 30, 2010, the Company wrote off $0.1 million and $0.4 million, respectively, in option deposits and pre-acquisition costs. Refer to Note 7 for additional details relating to write-offs of land option deposits and pre-acquisition costs.

NOTE 7. Valuation Adjustments and Write-offs

The Company assesses inventory for recoverability on a quarterly basis, by reviewing for impairment whenever events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable.

Operating communities. For existing operating communities that may have impairment indicators, the recoverability of assets is measured by comparing the carrying amount of the assets to future undiscounted cash flows expected to be generated by the assets based on home sales. These estimated cash flows are developed based primarily on management's assumptions relating to the specific community. The significant assumptions used to evaluate the recoverability of assets include: the timing of development and/or marketing phases; projected sales price and sales pace of each existing or planned community; the estimated land development, home construction, and selling costs of the community; overall market supply and demand; the local market; and competitive conditions.

Future communities. For raw land, land under development, or lots that management anticipates will be utilized for future homebuilding activities, the recoverability of assets is measured by comparing the carrying amount of the assets to future undiscounted cash flows expected to be generated by the assets based on home sales, consistent with the evaluations performed for operating communities discussed above.

For raw land, land under development, or lots that management intends to market for sale to a third party, but that do not meet all of the criteria to be classified as land held for sale as discussed above in Note 4, the recoverability of the assets is determined based on either the estimated net sales proceeds expected to be realized on the sale of the assets or the estimated fair value determined using cash flow valuation techniques.

If the Company has not yet determined whether raw land, land under development, or lots will be utilized for future homebuilding activities or marketed for sale to a third party, the Company assesses the recoverability of the inventory using a probability-weighted approach.

Land held for sale. Land held for sale includes land that meets the six criteria discussed above in Note 4. The Company records land held for sale at the lower of its carrying value or fair value less costs to sell. Fair value is determined based on the expected third party sale proceeds.

Investments in Unconsolidated Limited Liability Companies. The Company assesses investments in Unconsolidated LLCs for impairment on a quarterly basis. When evaluating the Unconsolidated LLCs, if the fair value of the investment is less than the investment's carrying value, and the Company determines the decline in value is other than temporary, the Company would write down the investment to fair value. The Company's Unconsolidated LLCs engage in land acquisition and development activities for the purpose of selling or distributing (in the form of a capital distribution) developed lots to the Company and its partners in the entity, as further discussed in Note 9.

As of September 30, 2010, we utilized discount rates ranging from 13% to 16% in the above valuations. The discount rate used in determining each asset's fair value depends on the community's projected life, development stage, and the inherent risks associated with the related estimated cash flow stream, as well as current risk free rates available in the market and estimated market risk premiums.

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A summary of the Company's valuation adjustments and write-offs for the three and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2010	2009	2010	2009
Impairment of operating communities:				
Midwest	$141	$7,033	$276	$9,896
Florida	72	2,821	583	6,693
Mid-Atlantic	110	22	3,086	4,001
Total impairment of operating communities (a)	$323	$9,876	$3,945	$20,590
Impairment of future communities:				
Midwest	$—	$1,524	$2,837	$1,524
Florida	1,473	3,474	3,134	3,474
Mid-Atlantic	—	—	1,290	—
Total impairment of future communities (a)	$1,473	$4,998	$7,261	$4,998
Option deposits and pre-acquisition costs write-offs:				
Midwest	$5	$24	$94	$547
Florida	94	6	95	20
Mid-Atlantic	41	42	208	921
Total option deposits and pre-acquisition costs write-offs (b)	$140	$72	$397	$1,488
Impairment of investments in Unconsolidated LLCs:				
Midwest	$—	$—	$—	$72
Florida	—	88	—	6,824
Mid-Atlantic	—	—	—	—
Total impairment of investments in Unconsolidated LLCs (a)	$—	$88	$—	$6,896
Total impairments and write-offs of option deposits and pre-acquisition costs	$1,936	$15,034	$11,603	$33,972

(a) Amounts are recorded within Impairment of inventory and investment in unconsolidated limited liability companies in the Company's Unaudited Condensed Consolidated Statements of Operations.

(b) Amounts are recorded within General and administrative expenses in the Company's Unaudited Condensed Consolidated Statements of Operations.

NOTE 8. Capitalized Interest

The Company capitalizes interest during land development and home construction. Capitalized interest is charged to cost of sales as the related inventory is delivered to a third party. A summary of capitalized interest is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2010	2009	2010	2009
Capitalized interest, beginning of period	$21,470	$25,387	$23,670	$25,838
Interest capitalized to inventory	2,495	2,942	7,480	7,221
Capitalized interest charged to cost of sales	(2,719)	(3,363)	(9,904)	(8,093)
Capitalized interest, end of period	$21,246	$24,966	$21,246	$24,966

Interest incurred — net	$4,447	$4,240	$13,652	$13,526

NOTE 9. Investment in Unconsolidated Limited Liability Companies

At September 30, 2010, the Company had interests ranging from 33% to 50% in Unconsolidated LLCs that do not meet the criteria of variable interest entities because each of the entities had sufficient equity at risk to permit the entity to finance its activities without additional subordinated support from the equity investors, and one of these Unconsolidated LLCs has outside financing that is not guaranteed by the Company. These Unconsolidated LLCs engage in land acquisition and development activities for the purpose of selling or distributing (in the form of a capital distribution) developed lots to the Company and its partners in the entity. The Company's maximum exposure related to its investment in these entities as of September 30, 2010 was the amount invested of $11.1 million plus letters of credit and bonds totaling $0.8 million. Included in the Company's investment in Unconsolidated LLCs at September 30, 2010 and December 31, 2009 were $0.9 million and $0.8 million, respectively, of capitalized interest and other costs. The Company does not have a controlling interest in these Unconsolidated LLCs; therefore, they are recorded using the equity method of accounting.

The Company evaluates its investment in Unconsolidated LLCs for potential impairment on a quarterly basis. If the fair value of the investment (see Note 4) is less than the investment's carrying value, and the Company determines the decline in value was other than temporary, the Company would write down the investment to fair value.

NOTE 10. Guarantees and Indemnifications

Warranty

The Company offers a limited warranty program in conjunction with a thirty-year transferable structural limited warranty on homes closed after September 30, 2007. This warranty program covers construction defects and certain damage resulting from construction defects for a statutory period based on geographic market and state law (currently ranging from five to ten years for the states in which the Company operates) and includes a mandatory arbitration clause. Prior to this warranty program, the Company provided up to a two-year limited warranty on materials and workmanship and a twenty-year (for homes closed between September 1, 1989 and April 24, 1998) and a thirty-year (for homes closed after April 24, 1998) transferable limited warranty against major structural defects. Warranty expense is accrued as the home sale is recognized and is intended to cover estimated material and outside labor costs to be incurred during the warranty period. The accrual amounts are based upon historical experience and geographic location. Our warranty accruals are included in Other liabilities in the Company's Unaudited Condensed Consolidated Balance Sheets. A summary of warranty activity for the three and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2010	2009	2010	2009
Warranty accrual, beginning of period	$8,478	$7,532	$8,657	$9,518
Warranty expense on homes delivered during the period	1,073	1,310	3,792	3,129
Changes in estimates for pre-existing warranties	159	234	139	(789)
Settlements made during the period	(1,596)	(2,048)	(4,474)	(4,830)
Warranty accrual, end of period	$8,114	$7,028	$8,114	$7,028

Guarantees and Indemnities

In the ordinary course of business, M/I Financial enters into agreements that guarantee certain purchasers of its mortgage loans that M/I Financial will repurchase a loan if certain conditions occur, primarily if the mortgagor does not meet those conditions of the loan within the first six months after the sale of the loan. Loans totaling approximately $166.2 million and $186.2 million were covered under these guarantees as of September 30, 2010 and December 31, 2009, respectively. A portion of the revenue paid to M/I Financial for providing these guarantees was deferred at September 30, 2010, and will be recognized in income as M/I Financial is released from its obligation under the guarantees. M/I Financial has not repurchased any loans under the above agreements in 2010 or 2009, but has provided indemnifications to third party investors in lieu of repurchasing certain loans. The total of these indemnified loans was approximately $3.7 million and $3.6 million at September 30, 2010 and December 31, 2009, respectively. The risk associated with the guarantees and indemnities above is offset by the value of the underlying assets. The Company has accrued management's best estimate of the probable loss on the above loans.

M/I Financial has also guaranteed the collectability of certain loans to third-party insurers of those loans for periods ranging from five to thirty years. The maximum potential amount of future payments is equal to the outstanding loan value less the value of the underlying asset plus administrative costs incurred related to foreclosure on the loans, should this event occur. The total of these costs are estimated to be $1.6 million and $1.8 million as of September 30, 2010 and December 31, 2009, respectively, and would be offset by the value of the underlying assets. The Company has accrued management's best estimate of the probable loss on the above loans.

The Company has recorded a liability relating to the guarantees and indemnities described above totaling $1.8 million and $1.7 million at September 30, 2010 and December 31, 2009, respectively, which is management's best estimate of the fair value of the Company's liability.

The Company has also provided a guarantee of the performance and payment obligations of M/I Financial, up to an aggregate principal amount of $13.0 million. The guarantee was provided to a government-sponsored enterprise to which M/I Financial delivers loans.

At September 30, 2010, the Company had $200 million aggregate principal amount of 6.875% senior notes outstanding (the

“Senior Notes”), which are fully and unconditionally guaranteed jointly and severally by substantially all of the Company's wholly-owned subsidiaries. The Company has no independent assets or operations, and any subsidiaries of the parent company other than the subsidiary guarantors are minor. The Company's obligations under its three-year secured revolving credit facility entered into on June 9, 2010 (the “Credit Facility”) are guaranteed by all of the Company's subsidiaries, with the exception of subsidiaries that are primarily engaged in the business of mortgage financing, the origination of mortgages for resale, title insurance or similar financial businesses relating to the homebuilding and home sales business and certain subsidiaries that are not wholly-owned by the Company or another subsidiary.

NOTE 11. Commitments and Contingencies

At September 30, 2010, the Company had sales agreements outstanding, some of which have contingencies for financing approval, to deliver 722 homes with an aggregate sales price of approximately $188.3 million . Based on our current housing gross margin of 11.7%, excluding the charge for impairment of inventory, less variable selling costs of 4.2% of revenue, less payments to date on homes in backlog of $92.6 million, we estimate payments totaling approximately $73.7 million to be made in 2010 relating to those homes. At September 30, 2010, the Company also has options and contingent purchase agreements to acquire land and developed lots with an aggregate purchase price of approximately $74.5 million. Purchase of properties is contingent upon satisfaction of certain requirements by the Company and the sellers.

At September 30, 2010, the Company had outstanding approximately $60.4 million of completion bonds and standby letters of credit, some of which were issued to various local governmental entities that expire at various times through December 2016. Included in this total are: (1) $20.6 million of performance and maintenance bonds and $25.6 million of performance letters of credit that serve as completion bonds for land development work in progress (including the Company's $0.6 million share of our Unconsolidated LLCs' letters of credit and bonds); (2) $8.9 million of financial letters of credit, of which $0.8 million represent deposits on land and lot purchase agreements; and (3) $5.3 million of financial bonds.

As of September 30, 2010, the Company has identified approximately 90 homes that have been confirmed as having defective imported drywall installed by our subcontractors. All of these homes are located in Florida. The Company accrued $12.8 million for the repair of these homes, of which $2.3 million remains at September 30, 2010, which is included in Other liabilities on the Company's Unaudited Condensed Consolidated Balance Sheets. During the third quarter of 2010, the Company received a $2.4 million settlement for claims attributed to the defective drywall. The Company has made demand for additional reimbursement from manufacturers, suppliers, insurers and others for costs the Company has incurred and may incur in the future in connection with the defective drywall; however, no additional recovery has been reflected in our financial statements.

NOTE 12. Legal Liabilities

On March 5, 2009, a resident of Florida and an owner of one of our homes filed a complaint in the United States District Court for the Southern District of Ohio, on behalf of himself and other similarly situated owners and residents of homes in the United States or alternatively in Florida, against the Company and certain other identified and unidentified parties (the “Initial Action”). The plaintiff alleges that the Company built his home with defective drywall, manufactured and supplied by certain of the defendants, that contains sulfur or other organic compounds capable of harming the health of individuals and damaging metals. The plaintiff alleges physical and economic damages and seeks legal and equitable relief, medical monitoring and attorney's fees. The Company filed a responsive pleading on or about April 30, 2009. This case has been consolidated with other similar actions not involving the Company and transferred to the Eastern District of Louisiana pursuant to an order from the United States Judicial Panel on Multidistrict Litigation for coordinated pre-trial proceedings (collectively, the “In Re: Chinese Manufactured Drywall

Product Liability Litigation”). In connection with the administration of the In Re: Chinese Manufactured Drywall Product Liability Litigation, the same homeowner and five other homeowners are named as plaintiffs in omnibus class action complaints filed in and after December 2009 against a certain identified manufacturer of drywall and others (including the Company) and one other homeowner is named as a plaintiff in another omnibus class action complaint filed in March 2010 against various unidentified manufacturers of drywall and others (including the Company) (collectively, the “MDL Omnibus Actions”). As they relate to the Company, the Initial Action and the MDL Omnibus Actions address substantially the same claims and seek substantially the same relief. During the third quarter of 2010, the Company entered into agreements with three of those homeowners named as plaintiffs pursuant to which the Company agreed to make repairs to their homes consistent with repairs made to the homes of other homeowners. The Company intends to vigorously defend against the remaining claims. Given the inherent uncertainties in this litigation, as of September 30, 2010, no accrual has been recorded (other than the accrual for repairs described in Note 11) because we cannot make a determination as to the probability of a loss resulting from this matter or estimate the range of possible loss, if any. Please refer to Note 11 for further information on this matter.

The Company and certain of its subsidiaries have been named as defendants in other claims, complaints and legal actions which are routine and incidental to our business. Certain of the liabilities resulting from these other matters are covered by insurance. While management currently believes that the ultimate resolution of these other matters, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, results of operations and cash flows, such matters are subject to inherent uncertainties. The Company has recorded a liability to provide for the anticipated costs, including legal defense costs, associated with the resolution of these other matters. However, there exists the possibility that the costs to resolve these other matters could differ from the recorded estimates and, therefore, have a material adverse effect on the Company's net income for the periods in which the matters are resolved. At September 30, 2010 and December 31, 2009, we had $1.3 million and $2.4 million, respectively, reserved for legal expenses.

NOTE 13. Debt

Note Payable Banks - Homebuilding

At September 30, 2010, borrowing availability under the Credit Facility was $34.5 million in accordance with the borrowing base calculation, and there were no borrowings outstanding and $0.2 million of letters of credit outstanding under the Credit Facility, leaving net remaining borrowing availability of $34.3 million. At September 30, 2010, the Company had pledged $98.5 million in aggregate book value of inventory to secure those outstanding letters of credit and any borrowings that we may make in the future under the Credit Facility. The Company can create additional borrowing availability under the Credit Facility to the extent it pledges additional assets. The borrowing availability can also be increased by increasing investments in assets currently pledged, but this is offset by the collateral value of homes delivered that are within the pledged asset pool. At September 30, 2010, the Company was in compliance with all covenants of the Credit Facility.

At September 30, 2010, there was $34.3 million outstanding under the Letter of Credit Facilities, which was collateralized with $35.6 million of the Company's cash.

Note Payable Banks — Financial Services

At September 30, 2010, M/I Financial had $23.8 million outstanding under its $45 million secured credit agreement that was entered into on April 27, 2010 (the "MIF Credit Agreement") and was in compliance with all covenants of that agreement.

Senior Notes

As of September 30, 2010, we had $200 million of Senior Notes outstanding. The notes are due April 2012 and are fully and unconditionally guaranteed jointly and severally by substantially all of the Company's wholly-owned subsidiaries. Under the Credit Facility, the Company is permitted to repurchase up to $50 million of Senior Notes if certain conditions are met and to refinance the Senior Notes in full.

The indenture governing our Senior Notes contains restrictive covenants that limit, among other things, the ability of the Company to pay dividends on common and preferred shares, or repurchase any shares. If our “restricted payments basket,” as defined in the indenture governing our Senior Notes, is less than zero, we are restricted from making certain payments, including dividends, as well as from repurchasing any shares. At September 30, 2010, our restricted payments basket was $(171.6) million. As a result of this deficit, we are currently restricted from paying dividends on our common shares and our 9.75% Series A Preferred Shares, and from repurchasing any shares under our common share repurchase program that was authorized by our Board of Directors in November 2005. These restrictions do not affect our compliance with any of the covenants contained in the Credit Facility and will not permit the lenders under the Credit Facility to accelerate the loans. As of September 30, 2010, the Company was in compliance with all covenants under the indenture governing our Senior Notes.

NOTE 14. Loss Per Share

Loss per share is calculated based on the weighted average number of common shares outstanding during each period. There are no adjustments to net loss necessary in the calculation of basic or diluted loss per share. The table below presents information regarding basic and diluted loss per share for the three and nine months ended September 30, 2010 and 2009:

(In thousands, except per share amounts)	Three Months Ended September 30,					
	2010			2009		
	Loss	Shares	Loss per share	Loss	Shares	Loss per share
Net loss to common shareholders	$(2,070)	18,523	$(0.11)	$(21,074)	18,514	$(1.14)
Effect of dilutive securities:						
Stock option awards	—	—	—	—	—	—
Deferred compensation awards	—	—	—	—	—	—
Diluted loss to common shareholders	$(2,070)	18,523	$(0.11)	$(21,074)	18,514	$(1.14)
Anti-dilutive stock equivalent awards not included in the calculation of diluted loss per share		2,100			1,771	

(In thousands, except per share amounts)	Nine Months Ended September 30,					
	2010			2009		
	Loss	Shares	Loss per share	Loss	Shares	Loss per share
Net loss to common shareholders	$(15,212)	18,523	$(0.82)	$(69,105)	16,127	$(4.29)
Effect of dilutive securities:						
Stock option awards	—	—	—	—	—	—
Deferred compensation awards	—	—	—	—	—	—
Diluted loss to common shareholders	$(15,212)	18,523	$(0.82)	$(69,105)	16,127	$(4.29)
Anti-dilutive stock equivalent awards not included in the calculation of diluted loss per share		2,050			1,710	

NOTE 15. Income Taxes

Deferred federal and state income tax assets primarily represent the deferred tax benefits arising from temporary differences between book and tax income which will be recognized in future years as an offset against future taxable income. These assets were largely generated as a result of inventory impairments that the Company incurred since late 2006. If, for some reason, the combination of future years' income (or loss), combined with the reversal of the timing differences, results in a loss, such losses can be carried forward to future years to recover the deferred tax assets.

The Company evaluates its deferred tax assets, including net operating losses, to determine if a valuation allowance is required. We are required to assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more likely than not” standard. In making such judgments, significant weight is given to evidence that can be objectively verified. A cumulative loss in recent years is significant negative evidence in considering whether deferred tax assets are realizable, and also restricts the amount of reliance on projections of future taxable income to support the recovery of deferred tax assets. The Company's current and prior year losses present the most significant negative evidence as to whether the Company needs to reduce its deferred tax assets with a valuation allowance. We are currently in excess of a four-year cumulative pre-tax loss position. We currently believe the cumulative weight of the negative evidence exceeds that of the positive evidence and, as a result, it is more likely than not that we will not be able to utilize all of our deferred tax assets. Therefore, for the nine months ended September 30, 2010, the Company has recorded an additional valuation allowance of $5.7 million, for a total valuation allowance recorded of $122.8 million, against its deferred tax assets. We do not expect to record any additional tax benefits in 2010 as our carryback under the current tax law has been exhausted. The accounting for deferred taxes is based upon an estimate of future results. Differences between the anticipated and actual outcomes of these future tax consequences could have a material impact on the Company's consolidated results of operations or financial position.

At September 30, 2010, the Company had a federal net operating loss carryforward of approximately $56.4 million. This federal carryforward benefit will begin to expire in 2029. The Company also had state net operating loss benefits of $13.1 million, with $0.1 million expiring between 2017 and 2021, $7.2 million expiring between 2022 and 2027, and $5.7 million expiring between

2028 and 2033.

NOTE 16. Financial Instruments

Counterparty Credit Risk. To reduce the risk associated with accounting losses that would be recognized if counterparties failed to perform as contracted, the Company limits the entities with whom management can enter into commitments. This risk of accounting loss is the difference between the market rate at the time of non-performance by the counterparty and the rate to which the Company committed.

The following table presents the carrying amounts and fair values of the Company's financial instruments at September 30, 2010 and December 31, 2009. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

	September 30, 2010		December 31, 2009	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash, including restricted cash	$ 92,002	$92,002	$132,232	$ 132,232
Mortgage loans held for sale	32,446	32,446	34,978	34,978

—	$ —	$ —	$7,351		—	—
Severance Related Benefits(6)						$ 987,000
Consulting Fees(7)						$ 100,000
Accelerated Vesting of Stock Grants(8)						$ 520,047
Long-term Cash Awards(9)						$ 129,293
Total Other Compensation	$186,723	$100,819	$68,047	$ 67,722	$96,869	$1,754,817

(1) Reimbursement by the Company for financial planning.

(2) Annual matching and non-contributory contributions by the Company to qualified 401(k) Savings Plan.

(3) Annual matching and non-contributory contributions by the Company to non-qualified deferred compensation plan.

(4) Annual long-term disability premium paid by the Company.

(5) Final relocation expenses paid by the Company for relocation Mr. Smith to North Charleston, South Carolina, the Company's headquarters. These expenses were paid pursuant to the Company's broad-based relocation policy that covers all Company salaried employees and incudes a gross-up feature. The gross-up for taxes paid on behalf of Mr. Smith was $162 in 2017.

(6) One-time cash severance payment to Mr. Rose in connection with his termination of employment.

(7) Consulting fees paid to Mr. Rose following his termination from the Company.

(8) Accelerated vesting of 11,561 Stock options with a value of $320,124 upon termination and 2,837 Performance-based RSUs at target which had a fair market value of $70.47 each and $199,923 in total on 12/31/2017.

(9) Long-term cash awards for Mr. Rose represent a $88,889 service based cash award that vested at time of Ingevity's spin-off from Westrock but did not pay out until time of termination and a $40,404 service based cash award that was paid by Ingevity to replace a cash award that was forfeited as a result of the spin off form Westrock.

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Grants of Plan-Based Awards in 2017

The following table reports plan-based awards granted to the NEOs during fiscal 2017. The material terms of our short- and long-term incentive compensation awards are described in Compensation Discussion and Analysis — Compensation Philosophy beginning on page 18.

ne	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[(1)] Threshold ($)	Target ($)	Maximum ($)	Estimated Future Payouts Under Equity Incentive Plan Awards[(2)] Threshold (# of awards)	Target (# of awards)	Maximum (# of awards)	All Other Stock Awards or Units (# of awards)[(3)]	All Other Option Awards (# of awards)[(4)]	Exercise Or Base Price of Option Awards[(5)] ($)	Grant D Fair Ma Value Stock Optio Award ($)
Michael son P											
ual ntive		425,000	850,000	1,700,000							
Js	5/27/2016				17,333	35,466	70,932				989,5
Js	5/27/2016							56,977			1,589,6
k ons	5/27/2016								48,170	27.90	509,1
Js	2/27/2017				10,003	20,006	40,012				1,062,5
Js	2/27/2017							10,003			531,2
k ons	2/27/2017								25,652	53.11	531,2
n C. tson P											
ual ntive		171,500	343,000	686,000							
Js	5/27/2016				9,471	18,941	37,882				528,4
Js	5/27/2016							38,715			1,080,1
k ons	5/27/2016								27,115	27.90	286,6
Js	2/27/2017				4,039	8,078	16,156				429,0
Js	2/27/2017							4,039			214,5
k ons	2/27/2017								10,357	53.11	214,4
herine urgeson P											
ual ntive		90,000	180,000	360,000							

Js	5/27/2016				2,661	5,322	10,644				148,4
Js	5/27/2016							5,320			148,2
k ons	5/27/2016								7,619	27.90	80,5
Js	2/27/2017				1,441	2,881	5,762				153,0
Js	2/27/2017							1,440			76,4
k ons	2/27/2017								3,694	53.11	76,5
hael P. th											
Js	2/27/2017	103,125	206,250	412,500	1,412	2,824	5,648				149,9
Js	2/27/2017							1,412			74,9
k ons	2/27/2017								3,612	53.11	74,9
dward odcock											
P ual ntive		82,550	16,500	330,000							
lacement n ard		—	48,611	—							
Js	5/27/2016				1,907	3,813	7,626				106,3
Js	5/27/2016							3,085			86,0
k ons	5/27/2016								5,178	27.90	54,7
Js	2/27/2017				1,130	2,259	4,518				119,9
Js	2/27/2017							1,130			60,0
k ons	2/27/2017								2,897	53.11	59,9
ward A. e											
P ual ntive		120,000	240,000	480,000							
lacement n ard		—	111,000	—							
Js	5/27/2016				4,256	8,512	17,024				237,4
Js	5/27/2016							6,940			193,6
k ons	5/27/2016								11,561	27.90	122,2

(1) *These columns reflect threshold, target and maximum amounts potentially payable under the Short-Term Incentive Plan. See Compensation Discussion and Analysis for discussion of the targets and amounts earned. This column*

also includes the Replacement Cash Awards granted to Messrs. Rose and Woodcock that were forfeited as a result of the Separation.

(2) *These columns reflect the threshold, target and maximum number of shares that may be earned pursuant to PSUs awarded under the Long-Term Incentive Plan. The Compensation Committee established individual award targets for each NEO and completed the long-term award commitments set forth in the Letter Agreements entered into by WestRock with Messrs. Wilson and Fortson and Ms. Burgeson.*

(3) *RSU awards vest ratably generally in one-third increments over a three-year period from the date on which the Compensation Committee approves compensation decisions in February of each calendar year; provided, however, that with respect to certain 2016 grants made to Messrs. Wilson and Fortson, the RSUs vest in one-third increments on the anniversary date of each NEO's respective hire date. The replacement RSU awards made to Messrs. Woodcock, Rose and Ms. Burgeson vest in full on February 27, 2018.*

(4) *All options granted in 2016 will vest in full on February 27, 2019; those granted in 2017 will vest in full on February 27, 2020.*

(5) *This represents the closing price of the Common Stock of the Company on the date of grant issuance.*

(6) *This amount represents the full grant fair market value of equity awards (PSUs, RSUs and options) computed in accordance with FASB ASC Topic 718. The fair market value of the PSUs is calculated at target.*

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Outstanding Equity Awards at 2017 Fiscal Year End

The table below shows the equity awards that have been previously awarded by the Company to our NEOs and which remained outstanding as of December 31 2017.

	Option Awards[1]					Stock Awards[2]			
Name (a)	Number of Securities Underlying Unexercised Options Exercisable (b)	Number of Securities Underlying Unexercised Options Unexercisable (c)	Number of Securities Underlying Unexercised Unearned Options (d)	Option Exercise Price ($) (e)	Option Expiration Date (f)	Number of Shares of Stock that have not yet Vested (g)	Market Value of Unvested Shares of Stock ($) (h)	Equity Incentive Plan Awards: Number of Unearned Unvested Units of Shares (i)[3]	Plan Awards Payout Value of Unearned, Unvested Units or Shares ($) (j)[4]
D. Michael Wilson	0	48,170	0	27.90	5/27/2026	35,082	2,472,229	55,472	3,909,112
	0	25,652	0	53.11	2/27/2027				
John C. Fortson	0	27,115	0	27.90	5/27/2026	20,170	1,421,380	27,019	1,904,029
	0	10,357	0	53.11	2/27/2027				
Katherine P. Burgeson	0	7,619	0	27.90	5/27/2026	5,853	412,461	8,203	578,065
	0	3,694	0	53.11	2/27/2027				
Michael P. Smith	0	3,621	0	53.11	2/27/2027	2,488	175,329	5,956	419,719
S. Edward Woodcock	0	5,178	0	27.90	5/27/2026	3,560	250,873	6,072	427,894
	0	2,897	0	53.11	2/27/2027				
Edward A. Rose	5,000	0	0	27.90	5/27/2026	0	0	2,837	199,923

(1) All options granted in 2016 will vest in full on February 27, 2019, those granted in 2017 will vest in full on February 27, 2020.

(2) The RSU awards vest ratably generally in one-third increments over a three-year period tied to the date on which the Compensation Committee approves compensation decisions in February of each calendar year; provided, however, that with respect to certain 2016 grants made to Messrs. Wilson and Fortson, the RSUs vest in one-third increments on the anniversary date of each NEO's respective hire date with WestRock. The replacement RSU awards made to Messrs. Woodcock and Ms. Burgeson vest in full on February 27, 2018.

(3) Column (j) includes PSU awards granted on May 27, 2016, which vest in full as determined by the Compensation Committee based on the Company's attainment of pre-established financial targets relating to return on invested capital for 2018 and cumulative earnings per share for the performance period beginning January 1, 2016 through December 31, 2018 with Compensation Committee evaluation of performance to be made after the close of the 2018 year. Those PSU awards granted on February 27, 2017, which vest in full as determined by the Compensation Committee based on the Company's attainment of pre-established financial targets relating to return

on invested capital for 2019 and cumulative earnings per share for the performance period beginning January 1, 2017 through December 31, 2019 with Compensation Committee evaluation of performance to be made after the close of the 2019 year. The number of PSU shares reported are based on the achievement of target performance.

(4) Market and payout values are based on the Company's Common Stock price of $70.47, which was the closing price of the Company's Common Stock on December 29, 2017.

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Option Exercises and Stock Vested during Fiscal 2017

This table shows the stock options that were exercised by, and the RSUs that vested for, each of our NEOs during 2017. Option award value realized is calculated by subtracting the aggregate exercise price of the options exercised from the aggregate market value of shares of Common Stock.

	Option Awards[1]		Stock Awards[2]	
	Number of Shares Acquired on Exercise (#)	Value Realized upon Exercise	Number of Shares Acquired on Vesting (#)	Value Realized Upon Vesting ($)
D. Michael Wilson	—	—	18,993	1,142,924
John C. Fortson	—	—	12,905	831,313
Katherine P. Burgeson	—	—	907	48,506
Michael P. Smith	—	—	537	28,719
S. Edward Woodcock	—	—	655	35,029
Edward A. Rose	6,561	337,285	2,391	130,715

(1) *The value realized upon exercise for Mr. Rose represents the difference between the exercise price and the stock price on the date of settlement.*

(2) *These amounts reflect the number of shares relating to RSUs that vested on the applicable vesting date, prior to withholding of any shares to satisfy taxes for each of the NEOs affected. The amounts for Messrs. Wilson, Fortson, Woodcock, Rose and Smith as well as Ms. Burgeson relate to 2016 RSU awards granted by the Company. The values realized upon vesting column for all NEOs represent the closing price on the date of settlement.*

Pension Benefits Table - 2017

The following table provides information with respect to the Company s non-qualified defined benefit plan (which we refer to as the Retirement Restoration Plan). The Retirement Restoration Plan provides benefits to only three of our NEOs (one of whom is a former executive) representing historic liabilities assumed by the Company under the terms of the EMA in connection with our separation from our former Parent, WestRock. None of our NEOs currently accrues a benefit under this plan with respect to service with the Company.

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit[1] ($)	Payments During Last Fiscal Year ($)
Katherine P. Burgeson	Retirement Restoration Plan	15.83	1,135,112	—
S. Edward Woodcock	Retirement Restoration Plan	27.083	344,111	—
Edward A. Rose	Retirement Restoration Plan	31.92	1,443,448	63,764

(1) *The accumulated benefits included in this column were computed through December 31, 2017 using the assumptions stated in the financial statements included in the 2017 Company Form 10-K (Note 13).*

Understanding Our Pension Benefits Table

The Company maintains the Retirement Restoration Plan, a non-qualified plan that mirrors benefits provided under a qualified defined benefit pension plan sponsored and maintained by our former Parent, WestRock (the WestRock Pension Plan). The Retirement Restoration Plan was adopted by the Company to honor obligations under the EMA between the Company and WestRock to pay certain assumed historic liabilities transferred as a result of the separation.

The WestRock Pension Plan (now frozen) provides an unreduced benefit payable at age 65 (or 62 if the employee has 20 years of service). The retirement benefit payable is equal to 1.6% of final average earnings (or pay) times years of benefit service (up to a maximum of 40 years), minus an

employee s primary social security benefit multiplied by 1.25% times years of benefit service (up to a maximum of 40 years of service). The formula is illustrated below:

[1.6% x Years of Benefit x Final Average Pay]
Service (up to 40)
-
[1.25% x Years of Benefit x Primary Social Security Benefit]
Service (up to 40)

The Retirement Restoration Plan mirrors benefits provided under the WestRock Pension Plan following the same formula but recognizing compensation in excess of the Internal Revenue Code limit, which was $270,000 for 2017. Messrs.

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Woodcock and Rose and Ms. Burgeson, while participants in this plan, no longer accrue any benefit under this plan. Benefits are payable in annuity form only and a lump sum is not available. The underlying plan, the WestRock Pension Plan, to which our Retirement Restoration Plan relates was

frozen (generally) on December 31, 2015. Accordingly, the values above represent an historic liability accrued under the former Parent s plan, the WestRock Pension Plan with respect to service performed for WestRock, not Ingevity.

Non-Qualified Deferred Compensation at 2017 Fiscal Year End

The Company maintains a non-qualified deferred compensation plan that permits executives to defer up to 80% of their base salary and 100% of their short-term incentive compensation. The plan also operates as an excess benefit plan enabling employees to defer salary, Company matching, transition and other non-contributing contributions in excess of Internal Revenue Code limits that apply to the Company s qualified 401(k) Savings Plan. Amounts contributed may be allocated towards notional accounts into

up to 16 investment funds as directed by the executive. There is no guaranteed investment return with respect to any of these funds. The funds mirror those options available to all employees who participate in the Company s broad-based qualified 401(k) Savings Plan including two additional funds. In 2017, the Company adopted the use of a Rabbi Trust which will be funded through the purchase of Company Owned Life Insurance.

The table below includes information on each of our NEO s non-qualified deferred compensation plan accounts for 2017.

	Executive Contributions in Last Fiscal Year[(1)] ($)	**Registrant Contributions in Last Fiscal Year[(2)] ($)**	**Aggregate Earnings in Last Fiscal Year ($)**	**Aggregate Withdrawals/ Distributions ($)**	**Aggregate Balance at Last Fiscal Year-End [(3)] ($)**
D. Michael Wilson	160,543	144,189	76,315	—	598,140
John C. Fortson	38,801	57,901	18,907	—	135,682
Katherine P. Burgeson	61,077	26,785	12,689	—	153,767
Michael P. Smith	22,423	18,952	1,595	—	31,261
S. Edward Woodcock	99,256	42,453	17,119	—	148,197
Edward A. Rose	0	0	211	17,837	17,940

(1) *After each NEO reaches the designated maximum contribution or contribution limit under the Company's 401(k) Savings Plan, he or she may continue to defer compensation under this plan, and separately he or she can defer up to 80% of his or her eligible compensation into the Company's plan. These amounts represent contributions made by each of our NEOs during 2017.*

(2) *These amounts represent contributions by the Company that exceeded the qualified plan contribution and compensation limits applicable to matching, non-elective, and transition contributions that would otherwise have been made to the Company's qualified 401(k) Savings Plan, but for the limits applicable to such plan.*

(3) *The amounts in this column are calculated by adding the amounts set forth in each of the first four columns of this table for each NEO to the applicable NEO's aggregate balance as of the end of fiscal 2016.*

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Potential Payments Upon Involuntary Termination[1]
(other than Change of Control)

The table below shows the severance benefits that would be payable to each of our NEOs if he or she had experienced an involuntary termination of employment from the Company on December 29, 2017 (absent cause and excluding death, disability or retirement), pursuant to the terms of Severance and Change of Control Agreements.

	D. Michael Wilson	John C. Fortson	Katherine P. Burgeson	Michael P. Smith	S. Edward Woodcock
Cash Severance[2]	$ 3,400,000	$ 1,249,500	$ 810,000	$ 581,250	$ 465,000
Prorated Target Incentive[3]	$ 850,000	$ 343,000	$ 180,000	$ 206,250	$ 165,000
Prorated Vesting Options[4]	$ 1,082,300	$ 609,219	$ 171,217	$ 77,261	$ 116,344
Prorated Vesting RSUs[5]	$ 1,319,128	$ 704,489	$ 197,950	$ 110,356	$ 141,856
Prorated Vesting PSUs[5]	$ 1,159,654	$ 132,625	$ 195,554	$ 56,869	$ 95,205
Long-Term Cash					$ 41,983
Post-Termination Health Care[6]	$ 39,062	$ 19,531	$ 19,306	$ 19,531	$ 19,531
Outplacement Services and Financial Planning[7]	$ 40,000	$ 40,000	$ 40,000	$ 40,000	$ 40,000
Total Other Compensation	$ 7,890,144	$ 3,098,364	$ 1,614,027	$ 1,091,517	$ 1,084,919

(1) *These amounts assume a stock price of $70.47, which was the closing price of the Company's stock on December 29, 2017, the assumed termination date. Actual values will vary based on changes in the Company's stock price on the termination date.*

(2) *Severance and Change in Control agreements entered into in 2017 with Messrs. Wilson, Fortson and Ms. Burgeson provide for the payment of cash severance in the amount of two times the sum of the executive's base salary and target annual incentive for Mr. Wilson, and one and one-half times the sum of the NEO's base salary and target annual incentive for Mr. Fortson and Ms. Burgeson. The severance is payable over two years for Mr. Wilson and eighteen months for Mr. Fortson and Ms. Burgeson. In the case of Messrs. Smith and Woodcock, both would receive a cash severance payment equal to one times their base salary and target annual incentive payable over a one-year period.*

(3) *This represents the value of the annual short-term incentive (assuming target performance levels) payable upon termination.*

(4) *This represents the intrinsic value of stock options that would vest in full in the event of an involuntary termination, other than for cause, absent a change of control, assuming a termination date occurred on December 29, 2017.*

(5) *These represent the value of 2016 and 2017 RSU and PSU awards which would vest in the event of an involuntary termination, other than for cause, absent a change of control, assuming target performance.*

(6) *This represents a cash lump sum payment in lieu of continued health care coverage pursuant to the executive's Severance and Change of Control Agreements. For Mr. Wilson, this represents the cost of two years of health care coverage for Mr. Fortson and Ms. Burgeson 18 months and for Mr. Smith and Mr. Woodcock one year.*

(7) *This represents the value of twelve months of outplacement services ($25,000), a benefit that is also provided for under the terms of the severance plan, as well as one year of financial counseling ($15,000).*

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Potential Payments Upon Termination — Retirement

The 2016 Omnibus Plan provides for accelerated vesting due to retirement at age 65 (or 55 with twenty years of service). None of the NEOs are eligible for special vesting rights under

the plan's retirement provisions assuming a December 31, 2017 termination date.

Potential Payments Upon Termination — Death or Disability(1)

The table below reflects the impact for death or disability as of December 31, 2017, under the terms of the Company s plans and programs.

	D. Michael Wilson	John C. Fortson	Katherine P. Burgeson	Michael P. Smith	S. Edward Woodcock
Intrinsic Value of Stock Option(2)	$ 2,495,916	$ 1,334,083	$ 388,469	$ 140,122	$ 270,719
Performance-Based RSU Award(3)	$ 1,319,128	$ 704,489	$ 197,950	$ 110,356	$ 141,856
Service-Based RSU Award(4)	$ 1,159,654	$ 132,625	$ 195,554	$ 56,869	$ 95,205
Long-Term Cash Award(5)					$ 41,983
Deferred Compensation(6)	$ 490,686	$ 135,682	$ 153,767	$ 31,260	$ 148,197
Total Other Compensation	$ 5,465,384	$ 2,306,879	$ 935,740	$ 338,607	$ 697,960

(1) *These amounts assume a stock price of $70.47, which was the closing price of the Company's stock on December 29, 2017, the assumed termination date. Actual values will vary based on changes in the Company's stock price on the termination date.*

(2) *This represents the intrinsic value of unvested stock options, that would vest as of the termination date following the death or disability of the executive.*

(3) *This represents the prorated value of 2016 PSU awards that would vest as of the termination date following the death or disability of the executive, assuming target performance with proration.*

(4) *This represents the prorated value of 2016 RSU awards that would vest as of the termination date following the death or disability of the executive.*

(5) *This represents the prorated value of Mr. Woodcock's 2016 Services Based Long-Term Cash replacement award that would vest as of the termination date following the death or disability of the executive.*

(6) *This represents the value of the executive's non-qualified deferred compensation account payment accelerated in the event of death or disability.*

Potential Payments Upon Termination and Change of Control

The Company has approved and entered into Severance and Change of Control Agreements with each of its NEOs (other than Mr. Rose). Under these agreements, participants are entitled to severance payments if their employment with Ingevity terminates within two years following a change of control (for any reason other than cause, disability, death or a termination initiated by the participant without good reason, all as defined). The table below reflects the amount of compensation that would be payable to each of our NEOs as if the NEO s employment had terminated on December 31, 2017 based on their respective Severance and Change of Control Agreements. The benefits described are in addition to any benefits available prior to the occurrence of a change of control, such as qualified plan distributions from the Company s 401(k) Savings Plan, payment of any accrued vacation or exercises of any stock options already exercisable.

For Messrs. Wilson, Fortson and Ms. Burgeson, if a change of control termination event occurs on or before January 1, 2019, and such NEO is terminated by the Company or any successor (or he or she terminates employment on account of Good Reason) before January 1, 2019 absent cause within

one year following a change of control, he or she is entitled to receive cash severance in the amount of three (3) years (for Mr. Wilson) and (2) years (for Mr. Fortson and Ms. Burgeson) of his or her then-current base salary and target bonus for such period, the payment of which is to be made over a three-year period (for Mr. Wilson) and two-years (for Mr. Fortson and Ms. Burgeson). For termination on or after January 1, 2019, Mr. Wilson would receive a severance payment equal to three (3) times the sum of his then current annual base salary and his target incentive, payable in a single lump sum. For Mr. Fortson and Ms. Burgeson, they would receive severance payments equal to two (2) times the sum of their then current annual base salary and their target incentive, payable in a single lump.

Messrs. Smith and Woodcock would receive severance payments equal to two (2) times the sum of their annual base salary and their target incentive, payable in a single lump sum in accordance with their agreements, which are consistent with the provisions discussed above for Messrs. Wilson and Fortson and Ms. Burgeson.

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Edward A. Rose

Mr. Rose left the Company on January 31, 2017. See our Form 8-K filed with the SEC on February 3, 2017 for more information on the actual amounts paid to him at that time.

No Gross-Up

The Severance and Change of Control Agreements covering our NEOs do not include any gross-up feature payable to NEOs with respect to any excise taxes owed in connection with a change of control severance payment.

Release of Claims and Noncompetition and Non-Solicitation Agreement

Severance is not payable to any NEO unless and until he or she signs a release of claims against the Company. The agreements also include post-termination covenants relating to confidentiality, non-competition and non-solicitation.

Equity Acceleration

In the event of a change of control event where the NEO receives a replacement award, there will be no accelerated vesting, exercisability, and/or payment of an outstanding award, unless the NEO s employment is terminated without cause, other than as a result of death or disability, or the NEO resigns for Good Reason within (2) years of the change of control event. In such cases, upon the second trigger, NEO holders of such awards will be entitled to accelerated vesting, and his or her awards will be exercisable and/or will be settled. If an NEO does not receive a replacement award or if the award is not otherwise assumed by the acquirer, then

upon the occurrence of a change of control, all outstanding unvested options will be fully vested and exercisable and all restrictions applicable to outstanding stock awards that are not performance-based will lapse in full and the awards will be fully vested. With respect to performance awards, upon a change of control, such awards will be considered earned at their target value (or, if greater, the level of achievement as of the date of the change of control, if determinable by the Compensation Committee) and will immediately be paid or settled subject to the provisions of Section 409A of the Code.

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Change of Control Severance Payments[1]

The table below reflects the impact of an involuntary termination of employment (or Good Reason termination, if applicable) on December 31, 2017 under the terms of the Company s Severance and Change of Control agreements in place with our NEOs in effect on December 31, 2017:

	D. Michael Wilson	John C. Fortson	Katherine P. Burgeson	Michael P. Smith	S. Edward Woodcock
Cash Severance[2]	$ 5,100,000	$ 1,666,000	$ 1,080,000	$ 1,162,500	$ 930,000
Pro-Rata Target Incentive[3]	$ 850,000	$ 343,000	$ 180,000	$ 206,250	$ 165,000
Intrinsic Value of Stock Option[4]	$ 2,495,916	$ 1,334,083	$ 388,469	$ 217,347	$ 270,719
Performance-Based RSU Award[5]	$ 3,909,112	$ 1,904,029	$ 578,065	$ 419,719	$ 427,894
Service-Based RSU Award[6]	$ 2,472,229	$ 1,421,380	$ 412,461	$ 213,172	$ 250,873
Long-Term Cash Award[7]	—	—	—		$ 48,611
Post-Termination Healthcare[8]	$ 58,594	$ 39,062	$ 38,612	$ 39,062	$ 39,062
Outplacement Services and Financial Planning[9]	$ 40,000	$ 40,000	$ 40,000	$ 40,000	$ 40,000
Deferred Compensation[10]	$ 490,686	$ 135,682	—		$ 148,197
Total	$ 15,416,537	$ 6,883,236	$ 2,717,607	$ 2,298,050	$ 2,320,356

(1) *These amounts assume a stock price of $70.47, which was the closing price of the Company's stock on December 29, 2017, the assumed termination date. Actual values will vary based on changes in the Company's stock price on the termination date.*

(2) *The change of control cash severance is equal to three times the sum of base salary plus the executive's current target annual cash incentive award for Mr. Wilson. For Messrs. Fortson, Smith, Woodcock and Ms. Burgeson, the change in control cash severance is equal to two times the sum of base salary plus the executive's current target annual cash incentive award.*

(3) *This represents the value of the annual short-term incentive (assuming target performance levels) payable upon termination in connection with a change of control.*

(4) *This represents the intrinsic value of unvested stock options, which vest as of the termination date following a change of control scenario.*

(5) *This represents the value of 2016 and 2017 PSU awards which would vest in full in connection with a termination following a change of control, assuming target performance with no proration.*

(6) *This represents the full value of 2016 and 2017 RSU awards that vest in full upon a termination of employment following a change of control.*

(7) *This represents the value of 2015 Long-Term Cash awards granted by WestRock, which vested at the Separation, but which are not payable until Mr. Woodcock's termination of employment.*

(8) *This represents a cash lump sum payment in lieu of continued health care coverage pursuant to each respective executive's Severance and Change of Control Agreement. For Mr. Wilson, this represents the cost of three years of health care coverage and for the other executives it represents two years.*

(9) *This represents the value of outplacement services for one year following termination of employment ($25,000) and financial counseling for one year ($15,000).*

(10) *This represents the value of the executive's non-qualified deferred compensation account payment accelerated in the event of a change of control based on the executive's election. Absent an executive election, no acceleration occurs on a change of control.*

RELATED PARTY TRANSACTIONS

Under its charter, the Governance Committee is charged with reviewing all potential related party transactions. Our policy has been that the Governance Committee, which is comprised solely of independent directors, reviews and then recommends such related party transactions to the entire Board for further review and approval. All such related party

transactions are then required to be reported under applicable SEC rules. Aside from this policy, we have not adopted additional procedures for review of, or standards for approval of, related party transactions but instead review such transactions on a case by case basis.

Transactions

The Governance Committee has not identified any related party transactions since the beginning of the fiscal year ended December 31, 2017 and none are currently proposed.

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AUDIT COMMITTEE REPORT

Management is responsible for the Company s financial reporting process, including the effectiveness of its internal control over financial reporting. The independent registered public accounting firm is responsible for performing an independent audit of the Company s financial statements and the Company s internal control over financial reporting and issuing reports thereon. The Audit Committee s responsibility is, among other things, to monitor and oversee these processes and to report thereon to the Board.

Throughout 2017, the Audit Committee received regular reports from management, the internal auditors and PricewaterhouseCoopers LLP, the Company s independent registered public accounting firm, regarding the plans for, and scope and results of, their audits and reviews of the Company s financial statements and internal control over financial reporting.

Management has represented to the Audit Committee that the Company s consolidated financial statements were prepared in accordance with generally accepted accounting principles, and the Audit Committee has reviewed and discussed the consolidated financial statements with management and PricewaterhouseCoopers LLP. This review

included discussions with PricewaterhouseCoopers LLP of the matters required to be discussed by Auditing Standard No. 1301, Communications with Audit Committees, as adopted by the Public Company Accounting Oversight Board.

The Audit Committee also received from PricewaterhouseCoopers LLP the written disclosures and letter required by applicable requirements of the Public Company Accounting Oversight Board regarding PricewaterhouseCoopers LLP s communications with the Audit Committee concerning independence and has discussed with PricewaterhouseCoopers LLP the issue of their independence from the Company.

Based on the foregoing, the Audit Committee recommended to the Board that the audited consolidated financial statements be included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017.

THE AUDIT COMMITTEE
Jean S. Blackwell, *Chair*
Luis Fernandez-Moreno
J. Michael Fitzpatrick
Daniel F. Sansone

CEO Pay Ratio Disclosure

The Compensation Committee reviewed a comparison of our Chief Executive Officer s (CEO) annual total compensation. We determined that the 2017 annual total compensation of the median compensated of all our employees who were employed as of December 31, 2017, other than our CEO, D. Michael Wilson, was $79,710; Mr. Wilson s 2017 annual total compensation was $4,933,902; and the ratio of these amounts was 1-to-62.

As of December 31, 2017, our total population consisted of 1,498 employees, of which 1,230 were in the United States and 268 were in non-US jurisdictions. Pursuant to the Pay Ratio SEC rules, we excluded nine (9) employees from India under the de minimis exemption. After applying this exemption, the employee population used for purposes of identifying the median employee consisted of 1,489 employees of which 1,230 were in the United States and 259 were located in non-US jurisdictions.

To identify the median compensated employee, we used total cash compensation, determined in the same manner as the Total Compensation column shown for our CEO in the Summary Compensation Table on page 27 of this proxy.

Pay elements that were included in the annual total compensation for each employee are:

- Base salary received in 2017
  - Annualized for those permanent employees hired mid-year during 2017
- Annual incentive paid or actual bonus paid for 2017
- Overtime and allowances, as applicable, for fiscal 2017
- Grant fair value of stock options, PSUs, and RSUs granted in 2017
- Company paid 401(k) contributions in 2017
- Company paid non-qualified plan contributions in 2017
- Company paid life insurance premiums in 2017

We believe this pay ratio is a reasonable estimate calculated in a manner consistent with the Pay Ratio Securities and Exchange Commission (SEC) rules under SEC rules based on our payroll and employment records and the methodology described above.

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PROPOSAL NO. 2 — ADVISORY VOTE TO APPROVE EXECUTIVE COMPENSATION (SAY-ON-PAY)

In accordance with the requirements of Section 14A of the Exchange Act, we are asking stockholders to approve, on an advisory basis, the following resolution concerning the compensation of our NEOs:

RESOLVED, that the Company s stockholders approve, on an advisory basis, the compensation of our named executive officers as described in this Proxy Statement, including the Compensation Discussion and Analysis and the tabular compensation disclosures and related narrative discussion.

In considering this proposal, we encourage you to review the CD&A beginning on page 16 and the tabular compensation disclosures and accompanying narrative discussion beginning on page 27. The CD&A describes our executive compensation philosophy, programs and objectives, while the tabular compensation disclosures and accompanying narrative discussion provide detailed information on the compensation of our NEOs.

We believe that our compensation policies and procedures are competitive, are focused on pay for performance principles and are strongly aligned with the long-term interests of our stockholders. Our executive compensation philosophy is based on the belief that the compensation of our employees should be set at levels that allow us to attract and retain employees who are committed to achieving high performance and who demonstrate the ability to do so. We

seek to provide an executive compensation package that is driven by our overall financial performance, increased stockholder value, the success of areas of our business directly impacted by the executive s performance, and the performance of the individual executive. We view our compensation program as a strategic tool that supports the successful execution of our business strategy and reinforces a performance-based culture. The Company employs an executive compensation program for our senior executives that emphasizes long-term compensation over short-term compensation, with a significant portion weighted toward equity awards. This approach strongly aligns our senior executives compensation with the interest of our stockholders.

This vote is not intended to address any specific item of compensation, but rather the overall compensation of our NEOs resulting from the executive compensation policies and practices described in this Proxy Statement.

Because your vote is advisory, it will not be binding upon the Board. However, the Board and Compensation Committee value the opinion of the Company s stockholders as expressed through their votes on this proposal and will carefully consider the outcome of this proposal in connection with their ongoing evaluation of the Company s executive compensation program.

Recommendation of the Board

The Board recommends that the stockholders vote FOR the adoption of this resolution and approve, on an advisory basis, the Company s executive compensation as described in this proxy statement.

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PROPOSAL NO. 3 — RATIFY APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee is directly responsible for appointing, retaining, fixing the compensation of, and overseeing the work of our independent registered public accounting firm. The Audit Committee has appointed PricewaterhouseCoopers LLP to serve as our independent registered public accounting firm for the fiscal year ending December 31, 2018.

Although it is not legally required to do so, the Board has elected to seek stockholder ratification of the appointment of PricewaterhouseCoopers LLP as a matter of good corporate governance. If stockholders do not ratify the appointment of

PricewaterhouseCoopers LLP, the Audit Committee will reconsider the appointment. Regardless of the outcome of this proposal, the Audit Committee may, in its discretion, select a new independent registered public accounting firm at any time during the year if it believes such a change would be in the Company s best interest.

Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting. They will have the opportunity to make a statement if they so desire and will be available to respond to appropriate questions from stockholders.

Recommendation of the Board

The Board recommends a vote FOR the ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm of the Company.

Audit and Other Fees

The following table shows the fees paid by us to PricewaterhouseCoopers LLP for audit and other services provided for the fiscal 2016 and 2017, all of which were preapproved by the Audit Committee. [1]

	2016 (In thousands)	2017 (In thousands)
Audit Fees:	$ 1,030	$ 1,132
Audit-Related Fees:	725	50
Tax Fees:	0	227
All Other Fees:	10	15
Total:	$ 1,765	$ 1,423

(1) Fees paid prior to the Separation, including fees paid with respect to the audited financial statements included in our Registration Statement on Form 10 filed with the SEC, were approved by our prior Parent, WestRock.

Audit Fees. This category includes fees associated with the audit of the Company s annual financial statements, the audit of internal control over financial reporting, review of the Company s quarterly financial statements included in its Forms 10-Q and assistance with review of documents filed with the SEC.

Audit-Related Fees. This includes fees paid for services rendered in connection with the audited financial statements included in our Registration Statement on Form 10 and related transactional support services associated with our Registration Statement on Form 10.

All Other Fees. This category includes fees for services in connection with attestations by PricewaterhouseCoopers LLP that are required by statute or regulation.

Pre-Approval Policy and Procedures

The Audit Committee s pre-approval policy requires that all services to be performed by the Company s independent registered public accounting firm be pre-approved either on a case-by-case basis by the Audit Committee or its delegate or on a categorical basis based on the Audit Committee s prior approval of a specific category of service and the

expected cost thereof. Any request for services involving less than $50,000 may be approved by the Chair of the Audit Committee if it is not practicable to obtain the approval of the full committee, provided that any such approval is presented to the full Audit Committee at its next scheduled meeting.

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QUESTIONS AND ANSWERS REGARDING STOCKHOLDER COMMUNICATIONS, STOCKHOLDER PROPOSALS AND COMPANY DOCUMENTS

How can I obtain copies of Ingevity’s Annual Report and Form 10-K?

We will provide without charge, at the written request of any stockholder of record as of February 27, 2018, a copy of our Annual Report on Form 10-K, including the financial statements and financial statement schedule, as filed with the SEC, excluding exhibits. We will provide copies of the exhibits to eligible stockholders making such a request.

Requests for copies of our Annual Report on Form 10-K should be mailed to: Ingevity Corporation, 5255 Virginia Ave, N. Charleston, SC 29406, Attn: Katherine P. Burgeson, Secretary. You may also access a copy of our annual report via the Internet by visiting our website located at http://ir.ingevity.com under the Financial Information tab.

How do I submit a proposal for inclusion next year’s proxy statement?

Under SEC rules, a proposal that a stockholder wishes to include in our proxy statement for the 2019 Annual Meeting must be received by our Corporate Secretary no later than the close of business on November 12, 2018. Proposals should be sent to: Ingevity Corporation, 5255 Virginia Ave, N.

Charleston, SC 29406, Attn: Katherine P. Burgeson, Secretary. Stockholders wishing to submit a proposal should refer to Rule 14a-8 of the Exchange Act, which sets standards for eligibility and specifies the types of proposals that are not appropriate for inclusion in our proxy statement.

How do I nominate a director for election at next year’s annual meeting of stockholders?

Under our bylaws, any stockholder entitled to vote in the election of directors at an annual meeting of our stockholders may nominate persons for election as directors by providing written notice of their intent to do so to our Corporate Secretary no less than 90 days and not more than 120 days prior to the first anniversary of the preceding year s annual

meeting. This means that written notice of any nominations intended to be made at the 2019 Annual Meeting must be delivered between December 27, 2018 and January 26, 2019. Any such notice must contain the information and conform to the requirements specified in our bylaws.

How do I bring other business before next year’s annual meeting of stockholders?

Under our bylaws, any stockholder of record wishing to present a matter (other than the nomination of a director or matters that have been submitted for inclusion in our proxy statement for such meeting) in person at the 2019 Annual Meeting must provide written notice to our Corporate Secretary no less than 90 days and not more than 120 days prior to the first anniversary of the preceding year’s annual meeting. This means that any notice regarding matters to be presented at the 2019 Annual Meeting must be delivered between December 27, 2018 and January 26, 2019. The notice must contain the information and conform to the requirements specified in our bylaws.

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APPENDIX-A NON-GAAP FINANCIAL MEASURES

In the CD&A, Ingevity has presented certain financial measures, defined below, which have not been prepared in accordance with U.S. generally accepted accounting principles (GAAP) These financial measures are not meant

to be considered in isolation or as a substitute for the most directly comparable financial measure calculated in accordance with GAAP.

Adjusted EBITDA

Adjusted EBITDA is defined as net income plus provisions for income taxes, interest expense, depreciation and amortization, separation costs and restructuring and other (income) charges.

In section entitled 2017 Performance Highlights and in the description of D. Michael Wilson s and John C. Fortson s individual performance achievements in the CD&A we discuss Adjusted EBITDA. For more information regarding the non-

GAAP financial measure Adjusted EBITDA for both fiscal years 2017 and 2016, including a reconciliation to the most directly comparable financial measure calculated in accordance with GAAP, please see Management s Discussion and Analysis of Financial Condition and Results of Operations — Use of Non-GAAP Financial Measures on page 45 of the 2017 Form 10-K.

Segment EBITDA

Segment EBITDA is defined as segment profit plus depreciation and amortization.

In the description of Michael P. Smith s and S. Edward Woodcock s individual performance achievements in the CD&A we discuss Segment EBITDA. For more information regarding the non-GAAP financial measure Segment EBITDA

for both fiscal years 2017 and 2016, including a reconciliation to the most directly comparable financial measure calculated in accordance with GAAP, please see Management s Discussion and Analysis of Financial Condition and Results of Operations — Use of Non-GAAP Financial Measures on page 45 of the 2017 Form 10-K.

STIP-Adjusted EBITDA

STIP-Adjusted EBITDA is defined as Adjusted EBIDTA, plus or minus the impact of Separation-related Reimbursement Awards and certain non-cash gains or charges.

In the section entitled 2017 Short-Term Incentive Plan (STIP) in the CD&A we discuss STIP-Adjusted EBITDA for fiscal year 2017. STIP-Adjusted EBITDA was selected as a performance measure under the Short Term Incentive Plan for 2017 because Adjusted EBITDA is the primary performance measurement of the Company s earnings guidance and drives behavior consistent with the stockholders interests.

Additionally, for compensation award purposes, eliminating the fair market gain or loss from the Separation-related Reimbursement Awards and other certain non-cash gains or losses was appropriate because the impacts of both were primarily driven by external market conditions and not by decisions management could directly influence.

The table below reconciles STIP-Adjusted EBITDA for 2017 to net income for 2017, the most comparable financial measure calculated in accordance with GAAP set forth in the Company s 2017 Form 10-K.

Free Cash Flow

Free Cash Flow is defined as operating cash flow less capital expenditures.

In the section entitled 2017 Performance Highlights in the CD&A we discuss Free Cash Flow for fiscal year 2017. Management believes that free cash flow is an important liquidity measure for the Company and that it is useful to

investors and management as a measure of the ability of our business to generate cash. The second table below reconciles the Company s Free Cash Flow for 2017 to net cash provided by operating activities for 2017, the most comparable financial measure calculated in accordance with GAAP set forth in the Company s 2017 10-K.

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Reconciliation of Net Income (GAAP) to Adjusted EBITDA (Non-GAAP) to STIP Adjusted EBITDA (Non-GAAP)

In millions, unaudited	Year Ending 2017	Year Ending 2016
Net income (loss) (GAAP)	$ 145.2	$ 44.4
Provision for income taxes	29.6	42.6
Interest expense	18.1	19.3
Interest income	(2.3)	(1.4)
Separation costs	0.9	17.5
Depreciation and amortization	40.4	38.8
Restructuring and other (income) charges	3.7	41.2
Acquisition Costs	7.1	—
Adjusted EBITDA (Non-GAAP)	$ 242.7	$ 202.4
Separation-related Reimbursement Awards(1)	0.3	1.6
Certain non-cash charges(2)	(3.3)	(0.7)
STIP Adjusted EBITDA (Non-GAAP)	$ 239.7	$ 203.3

(1) *For more information regarding the amount please see Note 6: Fair Value Measurements to the Notes to the Consolidated and Combined Financial Statements included within the Item 8. Financial Statements in our 2017 Form 10-K.*

(2) *Represents certain non-cash costs primarily including non-cash income resulting from inventory adjustments recorded during the period in accordance with last-in, first-out (LIFO) inventory accounting and non-cash translation impacts associated with currency exchange rate fluctuations.*

Segment EBITDA

In millions, unaudited	Year Ending 2017	Year Ending 2016
Performance Materials		
Segment operating profit (GAAP)	$ 122	$ 106.9
Depreciation and amortization	19.8	16.4
Segment EBITDA (Non-GAAP)	$ 141.8	$ 123.3
Net Sales	$ 349.3	$ 301.0
Segment operating margin	34.9 %	35.5 %
Segment EBITDA margin	40.6 %	41.0 %

	Year Ending 2017	Year Ending 2016
Performance Chemicals		
Segment operating profit (GAAP)	$ 80.3	$ 56.7
Depreciation and amortization	20.6	22.4
Segment EBITDA (Non-GAAP)	$ 100.9	$ 79.1

Net Sales	$ 623.1	$ 607.3
Segment operating margin	12.9 %	9.3 %
Segment EBITDA margin	16.2 %	13.0 %

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Reconciliation of Operating Cash Flow (GAAP) to Free Cash Flow (Non-GAAP)

In millions, unaudited	**Year Ending 2017**
Cash Flows from Operating Activities (GAAP)	$ 174.3
Capital expenditures	(52.6)
Free Cash Flow (Non-GAAP)	$ 121.7

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