

HUMANA INC  
Form 10-Q  
August 01, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011

OR

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

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

Commission file number 1-5975

**HUMANA INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**61-0647538**  
(I.R.S. Employer  
Identification Number)

500 West Main Street

Louisville, Kentucky 40202

(Address of principal executive offices, including zip code)

(502) 580-1000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

**Class of Common Stock**  
**\$0.16 2/3 par value**

**Outstanding at June 30, 2011**  
**166,829,524 shares**

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	<b>June 30, 2011</b>	<b>December 31, 2010</b>
	<b>(in thousands, except share amounts)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,567,824	\$ 1,673,137
Investment securities	7,609,737	6,872,767
Receivables, less allowance for doubtful accounts of \$80,195 in 2011 and \$51,470 in 2010:	1,546,392	959,018
Securities lending invested collateral	29,737	49,636
Other current assets	721,537	583,141
<b>Total current assets</b>	<b>11,475,227</b>	<b>10,137,699</b>
Property and equipment, net	822,611	815,337
Long-term investment securities	1,592,919	1,499,672
Goodwill	2,577,511	2,567,809
Other long-term assets	1,126,637	1,082,736
<b>Total assets</b>	<b>\$ 17,594,905</b>	<b>\$ 16,103,253</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Benefits payable	\$ 3,953,185	\$ 3,469,306
Trade accounts payable and accrued expenses	1,944,897	1,624,832
Book overdraft	217,287	409,385
Securities lending payable	35,536	55,693
Unearned revenues	204,859	185,410
<b>Total current liabilities</b>	<b>6,355,764</b>	<b>5,744,626</b>
Long-term debt	1,664,015	1,668,849
Future policy benefits payable	1,560,668	1,492,855
Other long-term liabilities	427,741	272,867
<b>Total liabilities</b>	<b>10,008,188</b>	<b>9,179,197</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$1 par; 10,000,000 shares authorized; none issued	0	0
Common stock, \$0.16 2/3 par; 300,000,000 shares authorized; 192,739,787 shares issued at June 30, 2011 and 190,244,741 shares issued at December 31, 2010	32,123	31,707
Capital in excess of par value	1,897,852	1,737,207
Retained earnings	6,262,943	5,529,001
Accumulated other comprehensive income	189,030	120,584
Treasury stock, at cost, 25,910,263 shares at June 30, 2011 and 21,795,051 shares at December 31, 2010	(795,231)	(494,443)
<b>Total stockholders' equity</b>	<b>7,586,717</b>	<b>6,924,056</b>

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Total liabilities and stockholders' equity	\$ 17,594,905	\$ 16,103,253
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See accompanying notes to condensed consolidated financial statements.

**Table of Contents****Humana Inc.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
(in thousands, except per share results)				
<b>Revenues:</b>				
Premiums	\$ 8,849,376	\$ 8,376,751	\$ 17,615,667	\$ 16,538,614
Services	343,509	132,702	678,451	265,722
Investment income	91,246	79,790	180,731	165,245
<b>Total revenues</b>	<b>9,284,131</b>	<b>8,589,243</b>	<b>18,474,849</b>	<b>16,969,581</b>
<b>Operating expenses:</b>				
Benefits	7,269,768	6,869,096	14,614,522	13,686,478
Operating costs	1,192,405	1,093,690	2,448,248	2,154,547
Depreciation and amortization	67,781	64,381	133,890	123,240
<b>Total operating expenses</b>	<b>8,529,954</b>	<b>8,027,167</b>	<b>17,196,660</b>	<b>15,964,265</b>
<b>Income from operations</b>	<b>754,177</b>	<b>562,076</b>	<b>1,278,189</b>	<b>1,005,316</b>
Interest expense	27,663	26,222	54,891	52,536
<b>Income before income taxes</b>	<b>726,514</b>	<b>535,854</b>	<b>1,223,298</b>	<b>952,780</b>
Provision for income taxes	266,227	195,778	447,835	353,936
<b>Net income</b>	<b>\$ 460,287</b>	<b>\$ 340,076</b>	<b>\$ 775,463</b>	<b>\$ 598,844</b>
Basic earnings per common share	\$ 2.76	\$ 2.02	\$ 4.64	\$ 3.56
Diluted earnings per common share	\$ 2.71	\$ 2.00	\$ 4.57	\$ 3.52
Dividends declared per common share	\$ 0.25	\$ 0.00	\$ 0.25	\$ 0.00

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****Humana Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>For the six months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>	
<b>Cash flows from operating activities</b>		
Net income	\$ 775,463	\$ 598,844
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital gains	(5,109)	(7,976)
Stock-based compensation	40,978	39,627
Depreciation and amortization	150,583	132,046
Provision (benefit) for deferred income taxes	21,418	(81,267)
Changes in operating assets and liabilities, net of effect of businesses acquired:		
Receivables	(587,374)	(501,482)
Other assets	(174,800)	73,683
Benefits payable	483,879	607,149
Other liabilities	202,069	219,163
Unearned revenues	19,449	(19,471)
Other, net	30,109	19,646
<b>Net cash provided by operating activities</b>	<b>956,665</b>	<b>1,079,962</b>
<b>Cash flows from investing activities</b>		
Acquisitions, net of cash acquired	(10,952)	(1,669)
Purchases of property and equipment	(129,181)	(91,427)
Purchases of investment securities	(1,902,083)	(2,759,168)
Maturities of investment securities	731,204	1,014,032
Proceeds from sales of investment securities	432,006	1,091,282
Change in securities lending collateral	20,157	74,809
<b>Net cash used in investing activities</b>	<b>(858,849)</b>	<b>(672,141)</b>
<b>Cash flows from financing activities</b>		
Receipts from CMS contract deposits	1,254,847	880,252
Withdrawals from CMS contract deposits	(1,066,478)	(643,976)
Change in securities lending payable	(20,157)	(74,809)
Change in book overdraft	(192,098)	(134,548)
Common stock repurchases	(300,788)	(57,869)
Excess tax benefit from stock-based compensation	11,287	1,264
Proceeds from stock option exercises and other	110,258	7,259
<b>Net cash used in financing activities</b>	<b>(203,129)</b>	<b>(22,427)</b>
(Decrease) increase in cash and cash equivalents	(105,313)	385,394
Cash and cash equivalents at beginning of period	1,673,137	1,613,588
<b>Cash and cash equivalents at end of period</b>	<b>\$ 1,567,824</b>	<b>\$ 1,998,982</b>

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**Supplemental cash flow disclosures:**

Interest payments	\$ 56,958	\$ 55,855
Income tax payments, net	\$ 407,416	\$ 356,390

See accompanying notes to condensed consolidated financial statements.



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**Humana Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**1. BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements are presented in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America, or those normally made in an Annual Report on Form 10-K. For further information, the reader of this Form 10-Q should refer to our Form 10-K for the year ended December 31, 2010, that was filed with the Securities and Exchange Commission, or the SEC, on February 17, 2011. References throughout this document to we, us, our, Company, and Humana mean Humana Inc. and its subsidiaries.

The preparation of our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The areas involving the most significant use of estimates are the estimation of benefits payable, the impact of risk sharing provisions related to our Medicare and TRICARE contracts, the valuation and related impairment recognition of investment securities, and the valuation and related impairment recognition of long-lived assets, including goodwill. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates. Refer to Note 2 to the consolidated financial statements included in our Form 10-K for the year ended December 31, 2010 for information on accounting policies that the Company considers in preparing its consolidated financial statements.

The financial information has been prepared in accordance with our customary accounting practices and has not been audited. In our opinion, the information presented reflects all adjustments necessary for a fair statement of interim results. All such adjustments are of a normal and recurring nature.

*Realignment of Business Segments*

During the first quarter of 2011, we realigned our business segments to reflect our evolving business model. We manage and report our operating results using the following segments: Retail, Employer Group, and Health and Well-Being Services. We also disclose results for Other Businesses. Historical segment information has been retrospectively adjusted to reflect the effect of this change. Our segment information is more fully described in Note 13.

As a result of changing our reportable segments, we also changed the classification of certain revenues and costs. Beginning January 1, 2011, costs of certain health and well-being services were reclassified as benefits expense including costs incurred by our wholly-owned home delivery pharmacy from transactions with our members that were historically classified as selling, general and administrative (and now titled operating costs), as well as depreciation and amortization expenses. The effect of this reclassification is to account for the cost of providing these benefits to our members similarly whether the services are provided via a third party provider or internally through a stand-alone subsidiary. Likewise, co-share amounts from our members associated with our wholly-owned home delivery pharmacy operations, historically classified as other revenue, are now classified as a reduction of benefits expense. The remaining items previously classified as other revenue, primarily consisting of patient service revenue associated with our recently acquired Concentra Inc. subsidiary, were combined with our previous administrative services fee revenue and are now classified as services revenue. Prior period amounts have been reclassified to conform to the new presentation. These adjustments had no impact on net income, cash flows or equity. Further, none of these adjustments impacted our regulated subsidiaries.

Depreciation and amortization expense associated with certain businesses in our Health and Well-Being Services segment delivering benefits to our members, primarily associated with our pharmacy operations, are now included with benefits expense. The amount of this expense was \$7.3 million and \$4.9 million for the three months ended June 30, 2011 and 2010, respectively. For the six months ended June 30, 2011 and 2010, the amount of this expense was \$16.7 million and \$8.8 million, respectively.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Unaudited**

**2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In July 2011, the Financial Accounting Standards Board, or FASB, issued new guidance regarding how health insurers should recognize and classify fees mandated by The Patient Protection and Affordable Care Act and The Health Care and Education Reconciliation Act of 2010 (which we collectively refer to as the Health Insurance Reform Legislation). The Health Insurance Reform Legislation imposes a non-deductible annual fee on health insurers for each calendar year beginning on or after January 1, 2014. The guidance requires that the liability for the fee should be estimated and recorded in full once we provide qualifying insurance coverage in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense over the calendar year that it is payable. The new guidance is effective for us for calendar year 2014, when the fee initially becomes effective.

In June 2011, the FASB issued new guidance requiring the presentation of other comprehensive income in a statement presented with equal prominence to the other primary financial statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of stockholders' equity and requires one of two alternatives for the presentation of items of net income and other comprehensive income: (1) in a single continuous statement referred to as the statement of comprehensive income, or (2) in two separate, but consecutive statements. Under either alternative, each component of net income and each component of other comprehensive income, together with totals for each, as well as total comprehensive income would need to be displayed. The new guidance is effective for us, beginning with the filing of our Form 10-Q for the three months ending March 31, 2012, with retrospective application required. As the new guidance only affects the presentation of other comprehensive income, it will not have a material impact on our results of operations, financial condition, or cash flows.

In May 2011, the FASB issued new guidance intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and those prepared in accordance with international financial reporting standards. While the new guidance is largely consistent with existing fair value measurement principles, it expands existing disclosure requirements for fair value measurements and makes other amendments which could change how existing fair value measurement guidance is applied. The new guidance will be effective for us beginning with the filing of our Form 10-Q for the three months ending March 31, 2012. We are currently evaluating the impact of the adoption of this new guidance on our results of operations, financial condition, or cash flows.

In January 2010, the FASB issued new guidance that expanded and clarified existing disclosures about fair value measurements. Under the new guidance, we are required to disclose additional information about movements of assets among the three-tier fair value hierarchy, present separately (that is, on a gross basis) information about purchases, sales, issuances, and settlements of financial instruments in the reconciliation of fair value measurements using significant unobservable inputs (Level 3), and expand disclosures regarding the determination of fair value measurements. We adopted the new disclosure provisions during the year ended December 31, 2010, except for the gross disclosures regarding purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements which we adopted with the filing of our Form 10-Q for the three months ended March 31, 2011 as provided in Note 5.

There are no other recently issued accounting standards that apply to us or that will have a material impact on our condensed consolidated financial statements.

**3. ACQUISITION**

On December 21, 2010, we acquired Concentra Inc., or Concentra, a health care company based in Addison, Texas, for cash consideration of \$804.7 million. During the first half of 2011, we accrued and paid \$3.7 million related to the final determination of working capital that existed at the acquisition date and recorded immaterial adjustments to the acquisition date fair value of Concentra's net tangible assets acquired with a corresponding adjustment to goodwill. Through its affiliated clinicians, Concentra delivers occupational medicine, urgent care, physical therapy, and wellness services to workers and the general public through its operation of medical centers and worksite medical facilities. The Concentra acquisition provides us entry into the primary care space on a national scale, offering additional means for achieving health and wellness solutions and providing an expandable platform for growth with a management team experienced in physician asset management and alternate

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site care. The total consideration of \$808.4 million exceeded our estimated fair value of the net tangible assets acquired by approximately \$724.5 million, of which we allocated \$188.0 million to other intangible assets and \$536.5 million to goodwill. The goodwill was assigned to the Health and Well-Being Services segment. The other intangible assets, which primarily consist of customer

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relationships and trade name, have a weighted average useful life of 13.7 years. Approximately \$57.9 million of the acquired goodwill is deductible for tax purposes. The purchase price allocation is preliminary, subject to completion of valuation analyses, including, for example, refining assumptions used to calculate the fair value of other intangible assets.

The results of operations and financial condition of Concentra have been included in our consolidated statements of income and consolidated balance sheets from the acquisition date. In connection with the acquisition, we recognized approximately \$14.9 million of acquisition-related costs, primarily banker and other professional fees, as operating costs in the fourth quarter of 2010. The pro forma financial information assuming the acquisition had occurred as of January 1, 2009 was not material to our results of operations.

**4. INVESTMENT SECURITIES**

Investment securities classified as current and long-term were as follows at June 30, 2011 and December 31, 2010, respectively:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
<b>June 30, 2011</b>				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	\$ 808,985	\$ 14,242	\$ (440)	\$ 822,787
Mortgage-backed securities	1,761,438	63,358	(760)	1,824,036
Tax-exempt municipal securities	2,437,115	63,506	(10,738)	2,489,883
Mortgage-backed securities:				
Residential	50,858	425	(1,534)	49,749
Commercial	397,262	18,618	(917)	414,963
Asset-backed securities	115,928	1,486	(29)	117,385
Corporate debt securities	3,321,621	165,184	(8,285)	3,478,520
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	\$ 8,898,540	\$ 326,819	\$ (22,703)	\$ 9,202,656
<b>December 31, 2010</b>				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	\$ 697,816	\$ 14,412	\$ (615)	\$ 711,613
Mortgage-backed securities	1,614,569	49,783	(1,173)	1,663,179
Tax-exempt municipal securities	2,439,659	37,294	(43,619)	2,433,334
Mortgage-backed securities:				
Residential	58,017	545	(2,675)	55,887
Commercial	306,291	14,911	(171)	321,031
Asset-backed securities	148,068	1,727	(44)	149,751
Corporate debt securities	2,906,228	139,793	(13,710)	3,032,311
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	\$ 8,175,981	\$ 258,465	\$ (62,007)	\$ 8,372,439

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We participate in a securities lending program where we loan certain investment securities for short periods of time in exchange for collateral, consisting of cash or U.S. Government securities, initially equal to at least 102% of the fair value of the investment securities on loan. Investment securities with a fair value of \$34.1 million at June 30, 2011 and \$54.0 million at December 31, 2010 were on loan as of those respective dates. At June 30, 2011, all collateral from lending our investment securities was in the form of cash which has been reinvested in money market funds.

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Gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at June 30, 2011 and December 31, 2010, respectively:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
<b>June 30, 2011</b>						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	\$ 74,009	\$ (440)	\$ 0	\$ 0	\$ 74,009	\$ (440)
Mortgage-backed securities	40,023	(422)	21,650	(338)	61,673	(760)
Tax-exempt municipal securities	480,854	(6,930)	63,336	(3,808)	544,190	(10,738)
Mortgage-backed securities:						
Residential	3,605	(59)	26,807	(1,475)	30,412	(1,534)
Commercial	96,425	(905)	156	(12)	96,581	(917)
Asset-backed securities	4,860	(9)	5,059	(20)	9,919	(29)
Corporate debt securities	398,311	(6,499)	14,548	(1,786)	412,859	(8,285)
Total debt securities	\$ 1,098,087	\$ (15,264)	\$ 131,556	\$ (7,439)	\$ 1,229,643	\$ (22,703)
<b>December 31, 2010</b>						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	\$ 141,766	\$ (615)	\$ 0	\$ 0	\$ 141,766	\$ (615)
Mortgage-backed securities	110,358	(1,054)	5,557	(119)	115,915	(1,173)
Tax-exempt municipal securities	1,168,221	(33,218)	97,809	(10,401)	1,266,030	(43,619)
Mortgage-backed securities:						
Residential	0	0	32,671	(2,675)	32,671	(2,675)
Commercial	0	0	2,752	(171)	2,752	(171)
Asset-backed securities	17,069	(42)	283	(2)	17,352	(44)
Corporate debt securities	383,677	(9,572)	31,464	(4,138)	415,141	(13,710)
Total debt securities	\$ 1,821,091	\$ (44,501)	\$ 170,536	\$ (17,506)	\$ 1,991,627	\$ (62,007)

Approximately 95% of our debt securities were investment-grade quality at June 30, 2011, with an average credit rating of AA- by S&P. Most of the debt securities that were below investment-grade were rated BB, the higher end of the below investment-grade rating scale. At June 30, 2011, 13% of our tax-exempt municipal securities were pre-refunded, generally with U.S. government and agency securities, and 25% of our tax-exempt securities were insured by bond insurers and had an equivalent S&P credit rating of AA exclusive of the bond insurers' guarantee. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

The recoverability of our residential and commercial mortgage-backed securities is supported by factors such as seniority, underlying collateral characteristics and credit enhancements. Our residential and commercial mortgage-backed securities at June 30, 2011 primarily were composed of senior tranches having high credit support, with 99% of the collateral consisting of prime loans. The average credit rating of all commercial mortgage-backed securities was AA at June 30, 2011.



**Table of Contents****Humana Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

All issuers of securities we own that were trading at an unrealized loss at June 30, 2011 remain current on all contractual payments. After taking into account these and other factors previously described, we believe these unrealized losses primarily were caused by an increase in market interest rates and tighter liquidity conditions in the current markets than when the securities were purchased. At June 30, 2011, we did not intend to sell the securities with an unrealized loss position in accumulated other comprehensive income, and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis. As a result, we believe that the securities with an unrealized loss were not other-than-temporarily impaired at June 30, 2011.

The detail of realized gains (losses) related to investment securities and included within investment income was as follows for the three and six months ended June 30, 2011 and 2010:

	For the three months ended June 30,		For the six months ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Gross realized gains	\$ 6,272	\$ 3,840	\$ 10,848	\$ 23,753
Gross realized losses	(5,089)	(4,558)	(5,739)	(15,777)
Net realized capital gains (losses)	\$ 1,183	\$ (718)	\$ 5,109	\$ 7,976

There were no material other-than-temporary impairments for the three and six months ended June 30, 2011 or 2010.

The contractual maturities of debt securities available for sale at June 30, 2011, regardless of their balance sheet classification, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	\$ 410,307	\$ 412,900
Due after one year through five years	1,993,459	2,066,110
Due after five years through ten years	2,450,596	2,547,202
Due after ten years	1,718,692	1,770,311
Mortgage and asset-backed securities	2,325,486	2,406,133
Total debt securities	\$ 8,898,540	\$ 9,202,656



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The following table summarizes our fair value measurements at June 30, 2011 and December 31, 2010, respectively, for financial assets measured at fair value on a recurring basis:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1) (in thousands)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>June 30, 2011</b>				
Cash equivalents	\$ 1,470,957	\$ 1,470,957	\$ 0	\$ 0
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	822,787	0	822,787	0
Mortgage-backed securities	1,824,036	0	1,824,036	0
Tax-exempt municipal securities	2,489,883	0	2,468,830	21,053
Mortgage-backed securities:				
Residential	49,749	0	49,749	0
Commercial	414,963	0	414,963	0
Asset-backed securities	117,385	0	116,286	1,099
Corporate debt securities	3,478,520	0	3,454,422	24,098
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	9,202,656	0	9,151,073	51,583
Securities lending invested collateral	29,737	29,737	0	0
Total invested assets	\$ 10,703,350	\$ 1,500,694	\$ 9,151,073	\$ 51,583
<b>December 31, 2010</b>				
Cash equivalents	\$ 1,606,592	\$ 1,606,592	\$ 0	\$ 0
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	711,613	0	711,613	0
Mortgage-backed securities	1,663,179	0	1,663,179	0
Tax-exempt municipal securities	2,433,334	0	2,381,528	51,806
Mortgage-backed securities:				
Residential	55,887	0	55,887	0
Commercial	321,031	0	321,031	0
Asset-backed securities	149,751	0	148,545	1,206

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Corporate debt securities	3,032,311	0	3,025,097	7,214
Redeemable preferred stock	5,333	0	0	5,333
Total debt securities	8,372,439	0	8,306,880	65,559
Securities lending invested collateral	49,636	24,639	24,997	0
Total invested assets	\$ 10,028,667	\$ 1,631,231	\$ 8,331,877	\$ 65,559

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Our Level 3 assets had a fair value of \$51.6 million at June 30, 2011, or less than 0.5% of our total invested assets. During the three and six months ended June 30, 2011 and 2010, the changes in the fair value of the assets measured using significant unobservable inputs (Level 3) were comprised of the following:

	For the three months ended June 30,					
	Auction Rate Securities	2011 Private Placements/ Venture Capital	Total	Auction Rate Securities	2010 Private Placements/ Venture Capital	Total
	(in thousands)					
Beginning balance at April 1	\$ 51,323	\$ 13,492	\$ 64,815	\$ 63,902	\$ 11,920	\$ 75,822
Total gains or losses:						
Realized in earnings	0	(380)	(380)	0	17	17
Unrealized in other comprehensive income	1,831	696	2,527	821	570	1,391
Purchases	0	17,000	17,000	0	3,000	3,000
Sales/calls	(32,525)	(373)	(32,898)	(2,500)	(500)	(3,000)
Settlements	425	94	519	(10,750)	(466)	(11,216)
Balance at June 30	\$ 21,054	\$ 30,529	\$ 51,583	\$ 51,473	\$ 14,541	\$ 66,014

	For the six months ended June 30,					
	Auction Rate Securities	2011 Private Placements/ Venture Capital	Total	Auction Rate Securities	2010 Private Placements/ Venture Capital	Total
	(in thousands)					
Beginning balance at January 1	\$ 51,806	\$ 13,753	\$ 65,559	\$ 68,814	\$ 23,909	\$ 92,723
Total gains or losses:						
Realized in earnings	16	(213)	(197)	16	6,195	6,211
Unrealized in other comprehensive income	1,757	615	2,372	1,368	(4,205)	(2,837)
Purchases	0	17,000	17,000	0	3,167	3,167
Sales/calls	(32,525)	(626)	(33,151)	(2,500)	(13,220)	(15,720)
Settlements	0	0	0	(16,225)	(1,305)	(17,530)
Balance at June 30	\$ 21,054	\$ 30,529	\$ 51,583	\$ 51,473	\$ 14,541	\$ 66,014

There were no material transfers between Level 1 and Level 2 during the three and six months ended June 30, 2011 or June 30, 2010.

**Financial Liabilities**

Our long-term debt is recorded at carrying value in our consolidated balance sheets. The carrying value of our long-term debt outstanding was \$1,664.0 million at June 30, 2011 and \$1,668.8 million at December 31, 2010. The fair value of our long-term debt was \$1,824.3 million at June 30, 2011 and \$1,746.5 million at December 31, 2010. The fair value of our long-term debt is determined based on quoted market prices for the same or similar debt, or, if no quoted market prices are available, on the current prices estimated to be available to us for debt with similar

terms and remaining maturities.

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We cover prescription drug benefits in accordance with Medicare Part D under multiple contracts with the Centers for Medicare and Medicaid Services, or CMS. The condensed consolidated balance sheets include the following amounts associated with Medicare Part D as of June 30, 2011 and December 31, 2010. The risk corridor settlement includes amounts classified as long-term because settlement associated with the 2011 provision will exceed 12 months as of June 30, 2011.

	June 30, 2011		December 31, 2010	
	Risk Corridor Settlement	CMS Subsidies	Risk Corridor Settlement	CMS Subsidies
	(in thousands)			
Other current assets	\$ 1,507	\$ 77,686	\$ 1,563	\$ 16,211
Trade accounts payable and accrued expenses	(400,806)	(420,075)	(389,203)	(170,231)
Net current liability	(399,299)	(342,389)	(387,640)	(154,020)
Other long-term assets	4,349	0	0	0
Other long-term liabilities	(147,235)	0	0	0
Net long-term liability	(142,886)	0	0	0
Total net liability	\$ (542,185)	\$ (342,389)	\$ (387,640)	\$ (154,020)

**7. GOODWILL AND OTHER INTANGIBLE ASSETS**

The realignment of our business segments and corresponding change in our reportable segments, more fully described herein in Note 13, resulted in a change in the composition of our reporting units, the unit of accounting for goodwill. Accordingly, we reassigned goodwill to our reporting units as of January 1, 2011 using the relative fair value approach. Changes in the carrying amount of goodwill, by our new reportable segments, for the six months ended June 30, 2011 were as follows:

	Retail	Employer Group	Health & Well-Being Services (in thousands)	Other Businesses	Total
Balance at January 1, 2011	\$ 592,844	\$ 61,990	\$ 1,855,522	\$ 57,453	\$ 2,567,809
Acquisitions	0	0	4,022	0	4,022
Subsequent adjustments	0	0	5,680	0	5,680
Balance at June 30, 2011	\$ 592,844	\$ 61,990	\$ 1,865,224	\$ 57,453	\$ 2,577,511

The following table presents details of our other intangible assets included in other long-term assets in the accompanying condensed consolidated balance sheets at June 30, 2011 and December 31, 2010:

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	Weighted Average Life	Cost	June 30, 2011 Accumulated Amortization	Net (in thousands)	Cost	December 31, 2010 Accumulated Amortization	Net
<b>Other intangible assets:</b>							
Customer contracts/relationships	10.7 yrs	\$ 417,285	\$ 165,807	\$ 251,478	\$ 413,855	\$ 145,997	\$ 267,858
Trade names	19.6 yrs	87,400	4,565	82,835	87,400	2,268	85,132
Provider contracts	16.0 yrs	42,753	13,347	29,406	42,753	11,659	31,094
Noncompetes and other	7.4 yrs	36,937	6,331	30,606	19,475	4,085	15,390
Total other intangible assets	12.2 yrs	\$ 584,375	\$ 190,050	\$ 394,325	\$ 563,483	\$ 164,009	\$ 399,474

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Amortization expense for other intangible assets was approximately \$26.0 million for the six months ended June 30, 2011 and \$18.1 million for the six months ended June 30, 2010. The following table presents our estimate of amortization expense for 2011 and each of the five next succeeding years:

	(in thousands)
For the years ending December 31,:	
2011	\$ 53,280
2012	53,102
2013	49,847
2014	45,349
2015	40,017
2016	34,342

**8. COMPREHENSIVE INCOME**

The following table presents details supporting the computation of comprehensive income, net of tax, for the three and six months ended June 30, 2011 and 2010:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Net income	\$ 460,287	\$ 340,076	\$ 775,463	\$ 598,844
Net unrealized investment gains and other, net of tax	80,222	88,434	68,446	116,293
Comprehensive income, net of tax	\$ 540,509	\$ 428,510	\$ 843,909	\$ 715,137

**9. EARNINGS PER COMMON SHARE COMPUTATION**

Detail supporting the computation of basic and diluted earnings per common share was as follows for the three and six months ended June 30, 2011 and 2010:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(in thousands, except per common share results)			
Net income available for common stockholders	\$ 460,287	\$ 340,076	\$ 775,463	\$ 598,844
Weighted average outstanding shares of common stock used to compute basic earnings per common share	167,021	168,472	167,146	168,336
Dilutive effect of:				
Employee stock options	1,073	533	996	566

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Restricted stock	1,466	1,224	1,405	1,252
Shares used to compute diluted earnings per common share	169,560	170,229	169,547	170,154
Basic earnings per common share	\$ 2.76	\$ 2.02	\$ 4.64	\$ 3.56
Diluted earnings per common share	\$ 2.71	\$ 2.00	\$ 4.57	\$ 3.52
Number of antidilutive stock options and restricted stock excluded from computation	139	4,770	1,441	4,904



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**Table of Contents****Humana Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited****10. STOCKHOLDERS EQUITY**

In April 2011, our Board of Directors approved a quarterly cash dividend policy and declared a cash dividend to stockholders of \$0.25 per share payable on July 28, 2011 to stockholders of record on June 30, 2011. Accordingly, on July 28, 2011, we paid dividends aggregating \$41.5 million. Declaration and payment of future quarterly dividends is at the discretion of the Board and may be adjusted as business needs or market conditions change.

In addition, in April 2011, the Board of Directors replaced its previously approved share repurchase authorization of up to \$250 million with a new authorization for repurchases of up to \$1 billion of our common shares exclusive of shares repurchased in connection with employee stock plans. The new authorization will expire June 30, 2013. Under this share repurchase authorization, shares could be purchased from time to time at prevailing prices in the open market, by block purchases, or in privately-negotiated transactions, subject to certain regulatory restrictions on volume, pricing, and timing. During the six months ended June 30, 2010, we repurchased 1.03 million shares in open market transactions for \$50.0 million at an average price of \$48.76 under the previously approved share repurchase authorization. During the six months ended June 30, 2011, we repurchased 0.8 million shares in open market transactions for \$52.6 million at an average price of \$63.73 under the previously approved share repurchase authorization and we repurchased 2.5 million shares in open market transactions for \$200.1 million at an average price of \$78.51 under the new authorization. As of August 1, 2011, the remaining authorized amount under the new authorization totaled \$799.9 million.

In connection with employee stock plans, we acquired 0.7 million common shares for \$48.1 million and 0.2 million common shares for \$7.9 million during the six months ended June 30, 2011 and 2010, respectively.

**11. INCOME TAXES**

The effective income tax rate was 36.6% for the three months ended June 30, 2011 compared to 36.5% for the three months ended June 30, 2010. For the six months ended June 30, 2011, the effective tax rate was 36.6% compared to 37.1% for the six months ended June 30, 2010. The higher tax rate for the six months ended June 30, 2010 primarily was due to the cumulative adjustment associated with estimating the retrospective aspect of new limitations on the deductibility of annual compensation in excess of \$500,000 per employee as mandated by the March 2010 health insurance reforms.

**12. GUARANTEES AND CONTINGENCIES*****Government Contracts***

Our Medicare business, which accounted for approximately 65% of our total premiums and services revenue for the six months ended June 30, 2011, primarily consisted of products covered under the Medicare Advantage and Medicare Part D Prescription Drug Plan contracts with the federal government. These contracts are renewed generally for a calendar year term unless CMS notifies us of its decision not to renew by August 1 of the calendar year in which the contract would end, or we notify CMS of our decision not to renew by the first Monday in June of the calendar year in which the contract would end. All material contracts between Humana and CMS relating to our Medicare business have been renewed for 2012 and we expect to learn in the Fall of 2011 the status of our product offerings filed with CMS for 2012.

CMS uses a risk-adjustment model which apportions premiums paid to Medicare Advantage plans according to health severity. The risk-adjustment model pays more for enrollees with predictably higher costs. Under this model, rates paid to Medicare Advantage plans are based on actuarially determined bids, which include a process whereby our prospective payments are based on a comparison of our beneficiaries risk scores, derived from medical diagnoses, to those enrolled in the government's original Medicare program. Under the risk-adjustment methodology, all Medicare Advantage plans must collect and submit the necessary diagnosis code information from hospital inpatient, hospital outpatient, and physician providers to CMS within prescribed deadlines. The CMS risk-



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adjustment model uses this diagnosis data to calculate the risk adjusted premium payment to Medicare Advantage plans. We generally rely on providers to code their claim submissions with appropriate diagnoses, which we send to CMS as the basis for our payment received from CMS under the actuarial risk-adjustment model. We also rely on providers to appropriately document all medical data, including the diagnosis data submitted with claims.

CMS is continuing to perform audits of various companies' selected Medicare Advantage contracts related to this risk adjustment diagnosis data. These audits are referred to herein as Risk-Adjustment Data Validation Audits, or RADV audits. RADV audits review medical record documentation in an attempt to validate provider coding practices and the presence of risk adjustment conditions which influence the calculation of premium payments to Medicare Advantage plans.

On December 21, 2010, CMS posted a description of the agency's proposed RADV sampling and payment adjustment calculation methodology to its website, and invited public comment, noting that CMS may revise its sampling and payment error calculation methodology based upon the comments received. We believe the audit and payment adjustment methodology proposed by CMS is fundamentally flawed and actuarially unsound. In essence, in making the comparison referred to above, CMS relies on two interdependent sets of data to set payment rates for Medicare Advantage (MA) plans: (1) fee for service (FFS) data from the government's original Medicare program; and (2) MA data. The proposed methodology would review medical records for only one set of data (MA data), while not performing the same exercise on the other set (FFS data). However, because these two sets of data are inextricably linked, we believe CMS must audit and validate both of them before determining the financial implications of any potential RADV audit results, in order to ensure that any resulting payment adjustment is accurate. We believe that the Social Security Act, under which the payment model was established, requires the consistent use of these data sets in determining risk-adjusted payments to MA plans. Furthermore, our payment received from CMS, as well as benefits offered and premiums charged to members, is based on bids that did not, by CMS design, include any assumption of retroactive audit payment adjustments. We believe that applying a retroactive audit adjustment after CMS acceptance of bids would improperly alter this process of establishing member benefits and premiums.

CMS has received public comments, including our comments and comments from other industry participants and the American Academy of Actuaries, which expressed concerns about the failure to appropriately compare the two sets of data. On February 3, 2011, CMS issued a statement that it was closely evaluating the comments it has received on this matter and anticipates making changes to the proposed methodology based on input it has received, although we are unable to predict the extent of changes that they may make.

To date, six Humana contracts have been selected by CMS for RADV audits for the 2007 contract year, consisting of one pilot audit and five targeted audits for Humana plans. We believe that the proposed methodology for these audits is actuarially unsound and in violation of the Social Security Act. We intend to defend that position vigorously. However, if CMS moves forward with implementation of the proposed methodology without changes to adequately address the data inconsistency issues described above, it would have a material adverse effect on our revenues derived from the Medicare Advantage program and, therefore, our results of operations, financial position, and cash flows.

Our Medicaid business, which accounted for approximately 2% of our total premiums and services revenue for the six months ended June 30, 2011, consists of contracts in Puerto Rico and Florida, with the vast majority in Puerto Rico. Effective October 1, 2010, as amended in May 2011, the Puerto Rico Health Insurance Administration, or PRHIA, awarded us three contracts for the East, Southeast, and Southwest regions for a three year term through June 30, 2013.

The loss of any of the contracts above or significant changes in these programs as a result of legislative action, including reductions in premium payments to us, or increases in member benefits without corresponding increases in premium payments to us, may have a material adverse effect on our results of operations, financial position, and cash flows.

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Our military services business, which accounted for approximately 10% of our total premiums and services revenue for the six months ended June 30, 2011, primarily consists of the TRICARE South Region contract. The original 5-year South Region contract expired on March 31, 2009 and was extended through March 31, 2011. On October 5, 2010, we were notified that the Department of Defense, or DoD, TRICARE Management Activity, or TMA, intended to negotiate with us for an extension of our administration of the TRICARE South Region contract, and on January 6, 2011, an Amendment of Solicitation/Modification of Contract to the TRICARE South Region contract became effective. The Amendment added one additional one-year option period, Option Period IX (which runs from April 1, 2011 through March 31, 2012). The TMA exercised Option Period IX on March 17, 2011.

As required under the current contract, the target underwritten health care cost and underwriting fee amounts are negotiated separately. Any variance from the target health care cost is shared with the federal government. Accordingly, events and circumstances not contemplated in the negotiated target health care cost amount may have a material adverse effect on us. These changes may include an increase or reduction in the number of persons enrolled or eligible to enroll due to the federal government's decision to increase or decrease U.S. military deployments. In the event government reimbursements were to decline from projected amounts, any failure to reduce the health care costs associated with these programs may have a material adverse effect on our results of operations, financial position, and cash flows.

In July 2009, we were notified by the DoD that we were not awarded the third generation TRICARE program contract for the South Region which had been subject to competing bids. We filed a protest with the Government Accountability Office, or GAO, in connection with the award to another bidder citing discrepancies between the award criteria and procedures prescribed in the request for proposals issued by the DoD and those that appear to have been used by the DoD in making its contractor selection. In October 2009, we learned that the GAO had upheld our protest, determining that the TMA evaluation of our proposal had unreasonably failed to fully recognize and reasonably account for the likely cost savings associated with our record of obtaining network provider discounts from our established network in the South Region. On February 25, 2011, TMA awarded the South Region contract to us. On March 7, 2011, the competing bidder filed a protest of the award with the GAO. Also on March 7, 2011, as provided in the Federal Acquisition Regulations, TMA issued a stop work order to us in connection with the award. On June 14, 2011, the GAO upheld the award of the contract to us and TMA subsequently lifted the stop work order. On June 21, 2011, the competing bidder filed a complaint in the United States Court of Federal Claims objecting to the award of the contract to us. That case is currently pending before the Court. Ultimate disposition of the contract award is subject to the resolution of the complaint filed by the unsuccessful bidder.

***Legal Proceedings and Certain Regulatory Matters******Provider Litigation***

Humana Military Healthcare Services, Inc. ( Humana Military ) was named as a defendant in Sacred Heart Health System, Inc., et al. v. Humana Military Healthcare Services Inc., Case No. 3:07-cv-00062 MCR/EMT (the Sacred Heart Complaint), a purported class action lawsuit filed on February 5, 2007 in the U.S. District Court for the Northern District of Florida asserting contract and fraud claims against Humana Military. The Sacred Heart Complaint alleged, among other things, that Humana Military breached its network agreements with a class of hospitals in six states, including the seven named plaintiffs, that contracted for reimbursement of outpatient services provided to beneficiaries of the DoD's TRICARE health benefits program ( TRICARE ). The Complaint alleged that Humana Military breached its network agreements when it failed to reimburse the hospitals based on negotiated discounts for non-surgical outpatient services performed on or after October 1, 1999, and instead reimbursed them based on published CHAMPUS Maximum Allowable Charges (so-called CMAC rates ). Humana Military denied that it breached the network agreements with the hospitals and asserted a number of defenses to these claims. The Complaint sought, among other things, the following relief for the purported class members: (i) damages as a result of the alleged breach of contract by Humana Military, (ii) taxable costs of the litigation, (iii) attorneys fees, and (iv) any other relief the court deems just and proper. Separate and apart from the class relief, named plaintiff Sacred Heart Health System Inc. requested damages and other relief for its individual claim against

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Humana Military for fraud in the inducement to contract. On September 25, 2008, the district court certified a class consisting of all institutional healthcare service providers in TRICARE former Regions 3 and 4 which had network agreements with Humana Military to provide outpatient non-surgical services to CHAMPUS/TRICARE beneficiaries as of November 18, 1999, excluding those network providers who contractually agreed with Humana Military to submit any such disputes with Humana Military to arbitration. On March 3, 2010, the Court of Appeals reversed the district court's class certification order and remanded the case to the district court for further proceeding. On June 28, 2010, the plaintiffs sought leave of the district court to amend their complaint to join additional hospital plaintiffs. Humana Military filed its response to the motion on July 28, 2010. The district court granted the plaintiffs' motion to join 33 additional hospitals on September 24, 2010. On October 27, 2010, the plaintiffs filed their Fourth Amended Complaint claiming the U.S. District Court for the Northern District of Florida has subject matter jurisdiction over the case because the allegations in the complaint raise a substantial question under federal law. The amended complaint asserts no other material changes to the allegations or relief sought by the plaintiffs. Humana Military's Answer to the Fourth Amended Complaint was filed on November 30, 2010.

On March 2, 2009, in a case styled *Southeast Georgia Regional Medical Center, et al. v. Humana Military Healthcare Services, Inc.*, the named plaintiffs filed an arbitration demand, seeking relief on the same grounds as the plaintiffs in the *Sacred Heart* litigation. The arbitration plaintiffs originally sought certification of a class consisting of all institutional healthcare service providers that had contracts with Humana Military to provide outpatient non-surgical services and whose agreements provided for dispute resolution through arbitration. Humana Military submitted its response to the demand for arbitration on May 1, 2009. The plaintiffs have subsequently withdrawn their motion for class certification. On June 18, 2010, plaintiffs submitted their amended arbitration complaint. Humana Military's answer to the complaint was submitted on July 9, 2010. On November 12, 2010, the arbitrators issued a revised case management and scheduling order and scheduled a hearing to begin on September 26, 2011.

Humana intends to defend each of these actions vigorously.

*Internal Investigation*

With the assistance of outside counsel, we are conducting an ongoing internal investigation related to certain aspects of our Florida subsidiary operations, and have voluntarily self-reported the existence of this investigation to CMS, the U.S. Department of Justice and the Florida Agency for Health Care Administration. Matters under review include, without limitation, the relationships between certain of our Florida-based employees and providers in our Medicaid and/or Medicare networks, practices related to the financial support of non-profit or provider access centers for Medicaid enrollment and related enrollment processes, and loans to or other financial support of physician practices. We have reported to the regulatory authorities noted above on the progress of our investigation to date, and intend to continue to discuss with these authorities our factual findings as well as any remedial actions we have taken or may take.

*Other Lawsuits and Regulatory Matters*

Our current and past business practices are subject to review or other investigations by various state insurance and health care regulatory authorities and other state and federal regulatory authorities. These authorities regularly scrutinize the business practices of health insurance and benefits companies. These reviews focus on numerous facets of our business, including claims payment practices, provider contracting, competitive practices, commission payments, privacy issues, utilization management practices, and sales practices, among others. Some of these reviews have historically resulted in fines imposed on us and some have required changes to some of our practices. We continue to be subject to these reviews, which could result in additional fines or other sanctions being imposed on us or additional changes in some of our practices.

On September 10, 2009, the Office of Inspector General, or OIG, of the United States Department of Health and Human Services issued subpoenas to us and our subsidiary, Humana Pharmacy, Inc., seeking documents related to

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our Medicare Part D prescription plans and the operation of *RightSourceRx*<sup>®</sup>, our home delivery pharmacy in Phoenix, Arizona. In July 2010, the government informed us that no additional materials will be sought pursuant to the subpoenas.

We also are involved in various other lawsuits that arise, for the most part, in the ordinary course of our business operations, including employment litigation, claims of medical malpractice, bad faith, nonacceptance or termination of providers, anticompetitive practices, improper rate setting, failure to disclose network discounts and various other provider arrangements, general contractual matters, intellectual property matters, and challenges to subrogation practices, certain of which may be styled as class-action lawsuits. We also are subject to claims relating to performance of contractual obligations to providers, members, and others, including failure to properly pay claims, improper policy terminations, challenges to our implementation of the Medicare Part D prescription drug program and other litigation.

Personal injury claims and claims for extracontractual damages arising from medical benefit denials are covered by insurance from our wholly owned captive insurance subsidiary and excess carriers, except to the extent that claimants seek punitive damages, which may not be covered by insurance in certain states in which insurance coverage for punitive damages is not permitted. In addition, insurance coverage for all or certain forms of liability has become increasingly costly and may become unavailable or prohibitively expensive in the future.

We record accruals for such contingencies to the extent that we conclude it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. No estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made at this time regarding the matters specifically described above because the inherently unpredictable nature of legal proceedings may be exacerbated by various factors, including: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) there are significant facts in dispute; (vi) there are a large number of parties (including where it is uncertain how liability, if any, will be shared among multiple defendants); or (vii) there is a wide range of potential outcomes.

The outcome of any current or future litigation or governmental or internal investigations, including the matters described above, cannot be accurately predicted, nor can we predict any resulting penalties, fines or other sanctions that may be imposed at the discretion of federal or state regulatory authorities. Nevertheless, it is reasonably possible that any such penalties, fines or other sanctions could be substantial, and the outcome of these matters may have a material adverse effect on our results of operations, financial position, and cash flows and may affect our reputation.

**13. SEGMENT INFORMATION**

During the first quarter of 2011, we realigned our business segments to reflect our evolving business model. As a result, we reassessed and changed our operating and reportable segments in the first quarter of 2011 to reflect managements' new view of the business and to align our external financial reporting with our new operating and internal financial reporting model. Historical segment information has been retrospectively adjusted to reflect the effect of this change. Our new reportable segments and the basis for determining those segments are discussed below.

We manage our business with three reportable segments: Retail, Employer Group, and Health and Well-Being Services. In addition, we include businesses that are not individually reportable because they do not meet the quantitative thresholds in an Other Businesses category. These segments are based on a combination of the type of health plan customer and adjacent businesses centered on well-being solutions for our health plans and other customers, as described below. These segment groupings are consistent with information used by our Chief Executive Officer to assess performance and allocate resources.

The Retail segment consists of Medicare and commercial fully-insured medical and specialty health insurance benefits, including dental, vision, and other supplemental health and financial protection products, marketed directly to individuals. The Employer Group segment consists of Medicare and commercial fully-insured medical and specialty health insurance benefits, including dental, vision, and other supplemental health and financial protection



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**Unaudited**

products, as well as administrative services only products marketed to employer groups. The Health and Well-Being Services segment includes services offered to our health plan members as well as to third parties that promote health and wellness, including primary care, pharmacy, integrated wellness, and home care services. The Other Businesses category consists of our Military services, primarily our TRICARE South region contract, Medicaid, and closed-block long-term care businesses as well as our contract with CMS to administer the Limited Income Newly Eligible Transition (LI-NET) program.

Our Health and Well-Being Services intersegment revenues primarily relate to managing prescription drug coverage for members of our other segments through Humana Pharmacy Solutions<sup>®</sup>, or HPS, and includes the operations of *RightSourceRx*<sup>®</sup>, our home delivery pharmacy business. These revenues consist of the prescription price (ingredient cost plus dispensing fee), including the portion to be settled with the member (co-share) or with the government (subsidies), plus any associated administrative fees. Service revenues related to the distribution of prescriptions by third party retail pharmacies in our networks are recognized when the claim is processed. Product revenues from dispensing prescriptions from our home delivery pharmacies are recorded when the prescription or product is shipped. Our pharmacy operations, which are responsible for designing pharmacy benefits, including defining member co-share responsibilities, determining formulary listings, selecting and establishing prices charged by retail pharmacies, confirming member eligibility, reviewing drug utilization, and processing claims, act as a principal in the arrangement on behalf of members in our other segments. As principal, our Health and Well-Being Services segment reports revenues on a gross basis including co-share amounts from members collected by third party retail pharmacies at the point of service.

We present our consolidated results of operations from the perspective of the health plans. As a result, the cost of providing benefits to our members, whether provided via a third party provider or internally through a stand-alone subsidiary, is classified as benefits expense and excludes the portion of the cost for which the health plans do not bear responsibility, including member co-share amounts and government subsidies of \$1.0 billion and \$0.9 billion for the three months ended June 30, 2011 and 2010, respectively. For the six months ended June 30, 2011 and 2010, these amounts were \$2.0 billion and \$1.7 billion, respectively.

Other than those described previously, the accounting policies of each segment are the same and are described in Note 2 to the consolidated financial statements included in our Form 10-K for the year ended December 31, 2010. Transactions between reportable segments consist of sales of services rendered by our Health and Well-Being Services segment, primarily pharmacy and behavioral health services, to our Retail and Employer Group customers. Intersegment sales and expenses are recorded at fair value and eliminated in consolidation. Members served by our segments often utilize the same provider networks, enabling us in some instances to obtain more favorable contract terms with providers. Our segments also share indirect costs and assets. As a result, the profitability of each segment is interdependent. We do not report total assets by segment since this is not a metric used to assess performance and allocate resources. We allocate most operating expenses to our segments. Certain corporate income and expenses are not allocated to the segments, including investment income not supporting segment operations, interest expense on corporate debt, and certain corporate expenses. These items are managed at the corporate level and are not the responsibility of segment management. These corporate amounts are reported separately from our reportable segments and included with intersegment eliminations in the tables presenting segment results below.



**Table of Contents****Humana Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

Our segment results were as follows for the three and six months ended June 30, 2011 and 2010, respectively:

	Retail	Employer Group	Health and Well-Being Services (in thousands)	Other Businesses	Eliminations/Corporate	Consolidated
<b>Three months ended June 30, 2011</b>						
Revenues - external customers						
Premiums:						
Medicare Advantage	\$ 4,555,163	\$ 764,595	\$ 0	\$ 0	\$ 0	\$ 5,319,758
Medicare stand-alone PDP	601,345	1,911	0	77,184	0	680,440
Total Medicare	5,156,508	766,506	0	77,184	0	6,000,198
Fully-insured	206,291	1,216,601	0	0	0	1,422,892
Specialty	29,580	233,233	0	0	0	262,813
Military services	0	0	0	934,738	0	934,738
Medicaid and other	0	0	0	228,735	0	228,735
Total premiums	5,392,379	2,216,340	0	1,240,657	0	8,849,376
Services revenue:						
Provider	0	0	222,401	0	0	222,401
ASO and other	3,894	86,657	0	27,945	0	118,496
Pharmacy	0	0	2,612	0	0	2,612
Total services revenue	3,894	86,657	225,013	27,945	0	343,509
Total revenues - external customers	5,396,273	2,302,997	225,013	1,268,602	0	9,192,885
Intersegment revenues						
Services	0	3,317	2,073,686	0	(2,077,003)	0
Products	0	0	433,869	0	(433,869)	0
Total intersegment revenues	0	3,317	2,507,555	0	(2,510,872)	0
Investment income	18,949	11,793	0	13,371	47,133	91,246
Total revenues	5,415,222	2,318,107	2,732,568	1,281,973	(2,463,739)	9,284,131
Operating expenses:						
Benefits	4,390,146	1,799,711	0	1,149,320	(69,409)	7,269,768
Operating costs	490,133	386,925	2,625,168	110,617	(2,420,438)	1,192,405
Depreciation and amortization	31,875	23,062	19,597	2,644	(9,397)	67,781

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Total operating expenses	4,912,154	2,209,698	2,644,765	1,262,581	(2,499,244)	8,529,954
Income from operations	503,068	108,409	87,803	19,392	35,505	754,177
Interest expense	0	0	0	0	27,663	27,663
Income before income taxes	\$ 503,068	\$ 108,409	\$ 87,803	\$ 19,392	\$ 7,842	\$ 726,514

**Table of Contents****Humana Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Unaudited**

	<b>Retail</b>	<b>Employer Group</b>	<b>Health and Well-Being Services</b>	<b>Other Businesses (in thousands)</b>	<b>Eliminations/ Corporate</b>	<b>Consolidated</b>
Free months included through the 30, 2020						
Revenues - External Customers						
Premiums:						
Medicare Advantage	\$ 4,106,667	\$ 778,542	\$ 0	\$ 0	\$ 0	\$ 4,885,209
Medicare Stand-alone P	504,296	1,154	0	194,772	0	700,222
Total Medicare	4,610,963	779,696	0	194,772	0	5,585,431
Privately-insured Specialty	183,261	1,300,759	0	0	0	1,484,020
Voluntary	19,668	224,093	0	0	0	243,761
Services	0	0	0	885,368	0	885,368
Medicaid and other	0	0	0	178,171	0	178,171
Total Premiums	4,813,892	2,304,548	0	1,258,311	0	8,376,751
Revenues - Services						
Provider	0	0	2,891	0	0	2,891
POS and Pharmacy	2,540	100,234	0	27,037	0	129,811
Other	0	0	0	0	0	0
Total Services Revenue	2,540	100,234	2,891	27,037	0	132,702
Total Revenues - External Customers	4,816,432	2,404,782	2,891	1,285,348	0	8,509,453

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Intersegment									
Revenues									
Services	0	3,279	1,923,802	0	(1,927,081)	0			
Products	0	0	306,983	0	(306,983)	0			
Total									
Intersegment									
Revenues	0	3,279	2,230,785	0	(2,234,064)	0			
Investment									
Income	19,529	10,207	0	10,027	40,027	79,790			
Total									
Revenues	4,835,961	2,418,268	2,233,676	1,295,375	(2,194,037)	8,589,243			
Operating									
Expenses:				\$	3,928,000				
	3/6/2014						150,000	\$ 23.86	\$ 1,681,500
Donald J. Tomnitz	11/7/2013	\$ 4,885,110							\$ 2,946,000
	11/7/2013			22,500		150,000	300,000		\$ 2,946,000
	3/6/2014						33,333	\$ 23.86	\$ 373,600
Rid V. Auld	11/7/2013	\$ 2,035,463							\$ 672,600
	3/6/2014						60,000	\$ 23.86	\$ 672,600
W. Wheat	3/6/2014						60,000	\$ 23.86	\$ 672,600
Deborah H. Meyer <sup>(4)</sup>									

(1) Represents the performance bonus paid based on consolidated pre-tax income in fiscal 2014. Additional information related to the pre-tax income bonus award is discussed under the heading *2014 Fiscal Year Annual Incentive Bonus Results and Payout* on page 28.

(2) Mr. Horton and Mr. Tomnitz were awarded a target amount of 200,000 and 150,000 2016 Performance RSUs, respectively. The threshold, target and maximum amounts reflect the number of 2016 Performance RSUs each executive could earn based on the level of performance attained for the three-year performance period and based on relative performance on four performance goals ranked against our peer group and the S&P 500 index.

The grant date fair value of the 2016 Performance RSUs was \$19.64 per unit and was determined in accordance with accounting guidance for share-based payments. These 2016 Performance RSUs are discussed under the heading *2014 Fiscal Year Award of 2016 Performance Restricted Stock Units Potential Vesting at September 30, 2016* on page 34 and the related grant date fair value of \$3,928,000 for Mr. Horton and \$2,946,000 for Mr. Tomnitz is reflected in the *Stock Awards* column in the *Summary Compensation Table* on page 42. Mr. Tomnitz retired after completing one year of the three-year performance period related to the 2016 Performance RSUs; therefore, he would be entitled to only one-third of the final payout on these awards in November 2016.

(3) All stock options were approved and granted on March 6, 2014 under the 2006 Stock Incentive Plan, as amended and restated, and have an exercise price of \$23.86, the closing price of our common stock on the date of approval and grant. The stock options for Mr. Horton and Mr. Tomnitz vest in three equal annual installments on each successive anniversary of the grant date beginning on the first anniversary date. The stock options for Mr. Auld and Mr. Wheat vest in five equal installments per year on each successive anniversary of the grant date beginning on the first anniversary date. All stock options have a ten-year term.

The grant date fair value of the options is \$11.21 per option and was determined using a Black-Scholes option pricing model in accordance with accounting guidance for share-based payments. The 2006 Stock Incentive Plan is discussed on page 39 and the related grant date fair value of each award is reflected in the *Option Awards* column in the *Summary Compensation Table* on page 42.

(4) Ms. Dwyer did not receive any grants of plan-based awards in fiscal 2014.

**Table of Contents****Outstanding Equity Awards at Fiscal Year-End**

The following table shows information about outstanding equity awards at September 30, 2014.

Name	Grant Date	Option Awards				Stock Awards	
		Number of Securities Underlying Unexercised Options Exercisable	Number of Securities Underlying Unexercised Options Unexercisable	Option Exercise Price	Option Expiration Date	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested	Equity Incentive Plan Awards: Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested
Donald R. Horton <sup>(1)</sup>	3/6/2014		150,000	\$ 23.86	3/6/2024		
	3/5/2013	50,000	100,000	\$ 23.80	3/5/2023		
	9/2/2011	300,000		\$ 9.97	9/2/2021		
	2/9/2009	300,000		\$ 9.03	2/9/2019		
	2/11/2008	300,000		\$ 14.50	2/11/2018		
	5/2/2006	150,000		\$ 29.44	5/2/2016		
	11/7/2013					200,000 <sup>(4)</sup>	\$ 4,104,000 <sup>(5)</sup>
	11/8/2012					200,000 <sup>(6)</sup>	\$ 4,104,000 <sup>(7)</sup>
Donald J. Tomnitz <sup>(2)</sup>	3/6/2014	33,333		\$ 23.86	9/30/2015		
	3/5/2013	100,000		\$ 23.80	9/30/2015		
	9/2/2011	133,333		\$ 9.97	9/30/2015		
	2/9/2009	80,000		\$ 9.03	9/30/2015		
	2/11/2008	40,000		\$ 14.50	9/30/2015		
	5/2/2006	100,000		\$ 29.44	9/30/2015		
	11/7/2013					50,000 <sup>(4)</sup>	\$ 1,026,000 <sup>(5)</sup>
	11/8/2012					100,000 <sup>(6)</sup>	\$ 2,052,000 <sup>(7)</sup>
David V. Auld <sup>(3)</sup>	3/6/2014		60,000	\$ 23.86	3/6/2024		
	3/5/2013	12,000	48,000	\$ 23.80	3/5/2023		
	9/2/2011	24,000	48,000	\$ 9.97	9/2/2021		
	2/9/2009		60,000	\$ 9.03	2/9/2019		
	2/11/2008		48,000	\$ 14.50	2/11/2018		
	5/2/2006	24,000	6,000	\$ 29.44	5/2/2016		
Bill W. Wheat <sup>(3)</sup>	3/6/2014		60,000	\$ 23.86	3/6/2024		
	3/5/2013	12,000	48,000	\$ 23.80	3/5/2023		
	9/2/2011	60,000	48,000	\$ 9.97	9/2/2021		
	2/9/2009	12,000	60,000	\$ 9.03	2/9/2019		
	2/11/2008		48,000	\$ 14.50	2/11/2018		
	5/2/2006	32,000	8,000	\$ 29.44	5/2/2016		
Stacey H. Dwyer							

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- (1) All stock option awards granted to Mr. Horton prior to September 2011 vest in five equal annual installments on each successive anniversary of the grant date commencing on the first anniversary date. Stock option awards granted in September 2011 forward vest in three equal annual installments beginning on the first anniversary date. All stock options have a ten-year term.
- (2) Mr. Tomnitz retired on September 30, 2014. Due to his retirement, all of Mr. Tomnitz's outstanding stock options that were unvested at that time became vested and all of his stock options will expire September 30, 2015, in accordance with the terms of the award.
- (3) All stock option awards granted to Mr. Auld and Mr. Wheat prior to September 2011 vest in ten equal annual installments on each successive anniversary of the grant date commencing on the first anniversary date for nine years with the final installment vesting on the date that is 9.75 years following the grant date. Stock option awards granted in September 2011 forward vest in five equal annual installments beginning on the first anniversary date. All stock options have a ten-year term.

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- (4) Represents the target number of 2016 Performance RSUs awarded. Mr. Tomnitz retired after completing one year of the three-year performance period related to the 2016 Performance RSUs; therefore, the 50,000 2016 Performance RSUs represents one-third of the initial grant amount of the 150,000 target number 2016 Performance RSUs. The maximum number of 2016 Performance RSUs that can be earned is 400,000 for Mr. Horton and 100,000 for Mr. Tomnitz upon maximum achievement of the performance goals. These 2016 Performance RSUs are described under *2014 Fiscal Year Award of 2016 Performance Restricted Stock Units Potential Vesting at September 30, 2016* on page 34.
- (5) The value of the 2016 Performance RSUs is based on the closing price of our common stock on September 30, 2014 of \$20.52. For Mr. Horton, the maximum market value of these 2016 Performance RSUs based on the stock price at September 30, 2014 is \$8,208,000 if maximum performance is achieved. For Mr. Tomnitz, the maximum market value of these 2016 Performance RSUs based on the stock price at September 30, 2014 is \$2,052,000 if maximum performance is achieved. These 2016 Performance RSUs are described under *2014 Fiscal Year Award of 2016 Performance Restricted Stock Units Potential Vesting at September 30, 2016* on page 34.
- (6) Represents the target number of 2015 Performance RSUs awarded. Mr. Tomnitz retired after completing two years of the three-year performance period related to the 2015 Performance RSUs; therefore, the 100,000 2015 Performance RSUs represents two-thirds of the initial grant amount of the 150,000 target number 2015 Performance RSUs. The maximum number of 2015 Performance RSUs that can be earned is 400,000 for Mr. Horton and 200,000 for Mr. Tomnitz upon maximum achievement of the performance goals.
- (7) The value of the 2015 Performance RSUs is based on the closing price of our common stock on September 30, 2014 of \$20.52. For Mr. Horton, the maximum market value of these 2015 Performance RSUs based on the stock price at September 30, 2014 is \$8,208,000 if maximum performance is achieved. For Mr. Tomnitz, the maximum market value of these 2015 Performance RSUs based on the stock price at September 30, 2014 is \$4,104,000 if maximum performance is achieved.

**Option Exercises and Stock Vested**

The following table shows information about option exercises and stock vested during our fiscal year ended September 30, 2014.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise	Value Realized on Exercise <sup>(1)</sup>	Number of Shares Acquired on Vesting <sup>(2)</sup>	Value Realized on Vesting <sup>(3)</sup>
Donald R. Horton	133,333	\$ 139,650	325,000	\$ 6,669,000
Donald J. Tomnitz	93,333	\$ 164,571	243,750	\$ 5,001,750
David V. Auld	145,767	\$ 1,238,813		
Bill W. Wheat	51,334	\$ 613,304		
Stacey H. Dwyer <sup>(4)</sup>	130,833	\$ 1,216,034		

- (1) Amounts represent the difference in the aggregate market value and the aggregate exercise price of the shares at the time of exercise.
- (2) Amounts represent the final number of 2014 Performance RSUs vested on September 30, 2014. The 2014 Performance RSUs were granted in November 2011.



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- (3) Amounts represent the number of 2014 Performance RSUs vested multiplied by the closing stock price on September 30, 2014 of \$20.52 per share.
- (4) Ms. Dwyer resigned from the Company in February 2014. All shares acquired by Ms. Dwyer were from exercising options after her resignation.

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**Table of Contents****Nonqualified Deferred Compensation Plans**

D.R. Horton has established the following nonqualified deferred compensation plans:

***Deferred Compensation Plan.*** The Deferred Compensation Plan permits participants, including D.R. Horton's executive officers and directors, to voluntarily defer receipt of up to 100% of bonus or director fee compensation from D.R. Horton and up to 90% of base salary from D.R. Horton. The participants earn a rate of return on their deferred amounts based on their selection from a variety of independently managed funds. The Company does not provide a guaranteed rate of return on these deferred amounts. The rate of return realized depends on the participant's fund selections and market performance of these funds. Upon his or her annual election, a participant's Deferred Compensation Plan benefit will be paid, or commence to be paid, upon separation from service or on a fixed date. Specified employees, as defined in Code Section 409A, generally cannot be paid until six months after separation from service (or, if earlier, upon a change in control). Payment may also be made upon death, disability or an unforeseeable emergency. Payments are made in a lump sum unless installments are elected. Amounts payable under the plan are not secured or held in trust, and the plan participants' rights to enforce payment are the same as a general unsecured creditor. However, upon a change in control (as defined in the Deferred Compensation Plan), all plan benefits will be fully funded through an irrevocable grantor trust (also known as a Rabbi trust). The participants, at their election, may choose to have the deferred amounts paid out through scheduled in-service distributions (in a lump sum or annual installments of between two and five years) or following the later of termination of employment or director service or attaining the age of 62. The Deferred Compensation Plan was adopted and approved by the Compensation Committee and ratified by the Board of Directors.

***SERP 2.*** Unlike the Deferred Compensation Plan, these are not elective deferrals, but rather the Company credits an amount to each participant's account. Participation in the SERP 2 is considered by the Compensation Committee annually at the beginning of the fiscal year. Pursuant to the SERP 2, if the executive is employed by the Company on the last day of a fiscal year, then the Company will establish a liability to such officer equal to 10% of his or her annual base salary as of the first day of such fiscal year. This liability will accrue earnings in future years at a rate established by the administrative committee for the SERP 2. Amounts payable under the SERP 2 are not secured or held in trust, and the plan participants' rights to enforce payment are the same as a general unsecured creditor. Amounts deferred under the SERP 2 are payable within 60 days following the retirement or termination of employment of the participant, the death or disability of the participant or a change in control of the Company. Provided however, specified employees, as defined in Code Section 409A, generally cannot be paid until six months after separation from service (or, if earlier, upon a change in control). The definition of change in control is described in *Potential Payments Upon Termination or Change in Control* on page 48. The form of distribution may be in a lump sum, or in quarterly installments over a period not to exceed five years, as elected by the participant.

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The following table shows, for each named executive officer, aggregate contributions, earnings and withdrawals/distributions during fiscal 2014 and outstanding balances as of September 30, 2014 under all of our nonqualified deferred compensation plans.

**Nonqualified Deferred Compensation**

Name	Executive Contributions in Last Fiscal Year		Registrant Contributions in Last Fiscal Year		Aggregate Earnings in Last Fiscal Year		Aggregate Withdrawals/Distributions		Aggregate Balance at Last Fiscal Year End	
	Deferred Cash		Deferred Cash		Deferred Cash		Deferred Cash		Deferred Cash	
	Compensation	SERP	Compensation	SERP(1)	Compensation(2)	SERP(3)	Compensation(4)	SERP(5)	Compensation(5)	SERP(6)
Donald R. Horton				\$ 100,000	\$ 399,846	\$ 220,097			\$ 8,151,571	\$ 2,440,229
Donald J. Tomnitz				\$ 90,000		\$ 168,279				\$ 1,879,259
David V. Auld				\$ 50,000		\$ 94,494				\$ 1,054,728
Bill W. Wheat				\$ 50,000		\$ 48,770				\$ 568,553
Stacey H. Dwyer <sup>(7)</sup>					\$ 1,510	\$ 47,673	\$ 41,147		\$ 199,648	\$ 506,891

- (1) Represents the amount of unfunded, unsecured liabilities created by the Company on behalf of each participant in fiscal 2014 under the SERP 2. Such amount is also included in the *All Other Compensation* column of the *Summary Compensation Table* on page 42.
- (2) Represents the net amount of earnings on the balance of the participant's account that is the result of the performance of a variety of independently managed funds available to and selected by each participant under the Deferred Compensation Plan. The Company does not provide a guaranteed or fixed rate of return on these funds. The rate of return on these funds depends on the participant's investment selections and on the market performance of these funds. These amounts are not included in the *Summary Compensation Table* on page 42 because such amount was not preferential or above-market.
- (3) Represents the amount of earnings on the balance of the participant's account at a rate determined by the SERP 2 plan administrator, typically 10% per annum. Those portions of earnings that are considered above-market are included in the *Change in Pension Value and Nonqualified Deferred Compensation Earnings* column of the *Summary Compensation Table* on page 42. The above-market portion of earnings for each of the above individuals for fiscal 2014 is: Mr. Horton: \$132,324; Mr. Tomnitz: \$101,170; Mr. Auld: \$56,810; Mr. Wheat: \$29,321; and Ms. Dwyer: \$28,661.
- (4) Represents a required distribution resulting from an election made in a prior year.
- (5) These balances of deferred compensation represent compensation earned in prior years and would have been included in the Summary Compensation Table in prior year proxy statements in the year earned.
- (6) Includes amounts of unfunded, unsecured liabilities and the related earnings created by the Company on behalf of each participant with respect to the current and prior fiscal years under the SERP 2. Mr. Tomnitz is entitled to his amount under the terms of the SERP 2 due to his retirement. Ms. Dwyer is entitled to her amount under the terms of the SERP 2 due to her resignation.

(7) Ms. Dwyer resigned from the Company in February 2014.

**Potential Payments Upon Termination or Change in Control**

None of our named executive officers has employment or change in control agreements with us specifically providing for payments upon involuntary termination of their employment. However, certain of our benefit and incentive plans contain various provisions regarding termination of employment or change in control. Any additional severance payments would be at the discretion of the Compensation Committee and determined at the time of termination. The following is a summary of the treatment of benefits under our benefit plans for various reasons for termination, including upon a change in control.

Generally, our benefit plans define "cause" as a violation of the standards of employee conduct set forth in our employee manual and "change in control" as the occurrence of any of the following events:

(i) Our merger, consolidation or reorganization into another entity if our stockholders immediately before such transaction do not, immediately after such transaction, own more than 50% of the combined voting power of

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the outstanding voting securities resulting from such transaction and in substantially the same proportion as their stock ownership prior to the transaction;

(ii) We sell all or substantially all of our assets to another entity or we completely liquidate or dissolve;

(iii) A person (as defined by Section 13(d)(3) or Section 14(d)(2) of the Exchange Act) becomes the beneficial owner (as the term "beneficial owner" is defined under Rule 13d-3 or any successor rule or regulation promulgated under the Exchange Act) of securities representing 20% or more of the combined voting power of the then outstanding voting securities (the threshold for amounts deposited under our SERP 2 plan on or after January 1, 2005 is 50% or 35% acquired in a single transaction or series of transactions in any 12-month period); and

(iv) During any two-year period, a majority of the members of the Board serving at the date of the most recent approval of our benefit plan by stockholders is replaced by members of the Board who are not nominated and approved by the Board.

For purposes of calculating beneficial ownership pursuant to this paragraph, no voting securities held by our Chairman, Donald R. Horton, as of the date of the adoption of the plan in question or received in any merger transaction shall be included in the calculation.

With regard to our amended and restated 2000 Incentive Bonus Plan, the definition of "change in control" differs from the generally applicable provisions described above in two ways. It includes one additional change in control event relating to board composition and it uses a different threshold for and a different exclusion from beneficial ownership for the change in control event described in paragraph (iii) above. Additionally, under the 2000 Incentive Bonus Plan, the threshold for a person's acquisition of beneficial ownership to trigger a "change in control" event is 50%, and this definition explicitly excludes from the group of persons that may trigger this change in control the Company, Donald R. Horton, Terrill J. Horton, their respective wives, children, grandchildren, and other descendants, and any trust or other entity formed or controlled by any such individuals.

***2006 Stock Incentive Plan and the 1991 Stock Incentive Plan***

Our D.R. Horton 2006 Stock Incentive Plan and 1991 Stock Incentive Plan plans provide for accelerated vesting of all outstanding unvested options granted under the plans in the event of a change in control or in the event of a participant's death, disability or retirement at the retirement age specified in the plan and the participant or his or her beneficiary, as applicable, will be entitled to exercise such options for a period of one year in the event of retirement or two years in the event of death or disability. In the event the participant's employment is terminated by the Company without cause or by the participant voluntarily, the participant will be entitled to exercise any options vested as of the date of termination for a period of three months following such termination. If the participant is terminated by the Company for cause, all options will immediately terminate and the participant will forfeit all vested options.

***Amended and Restated Supplemental Executive Retirement Plan No. 2 (SERP 2)***

Under the SERP 2, all amounts deferred shall be paid (either in lump sum or in quarterly installments as elected by the participant) within 60 days following the date of the participant's retirement or termination of employment, disability, death or change in control of the Company; provided, however, specified employees, as such term is defined in Section 409A of the Internal Revenue Code, must wait six months following termination of employment before payments accrued on or after January 1, 2005 can be made or commence. In the event the Company terminates a participant for cause, all benefits under the SERP 2 will be forfeited and no payments will be made to the participant. In the event of a change in control, all amounts deferred shall be paid (in accordance with the participant's election) within 60 days following the date of the change in control.

Notwithstanding the foregoing, a participant's election as to form of payment (lump sum or installment) must have been made at least 12 months prior to distribution. If a termination event occurs and no election has been made, the distributions of pre-2005 accruals will be made or commence on the first day of the 13th month following the date of election, and the distribution of post-2004 accruals will be made in a lump sum upon termination of employment (or six months later for specified employees).

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***Table Potential Payments Upon Termination or Change in Control***

The following table reflects amounts of compensation to be paid to each of the named executive officers in the event of termination of employment or change in control. Because neither the Company nor any of its plans provides for additional benefits related to a change in control termination, if such a termination is triggered, the payments would be as set forth under the applicable column under *Termination of Employment*.

The amounts in the table assume a termination date of September 30, 2014, the last day of our fiscal year, and, if applicable, are based on the closing price of our common stock of \$20.52 on September 30, 2014. Because only Mr. Tomnitz was at the normal retirement age (65 years old) on September 30, 2014, we only included amounts payable upon retirement for him. These amounts are estimates of payments to executives upon termination of employment or a change in control. Actual amounts can only be determined at the time of such executive's actual separation from the Company or change in control. Factors that could affect these amounts include the timing during the year of any such event, the company's stock price and the executive's age. Amounts to be provided to an executive under arrangements that do not discriminate in scope, terms or operation in favor of our executive officers and are available to all salaried employees are not included in the following table in accordance with SEC regulations.

In addition to the amounts set forth below, each of the named executive officers would be entitled to receive, upon certain termination events or a change in control, a distribution of his or her outstanding balance of compensation earned in prior years and deferred, at the executive officer's option, under our Deferred Compensation Plan. The balances of such accounts are set forth and explained in the *Nonqualified Deferred Compensation* table on page 48.

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The table reflects compensation to be paid based on the listed events if such events occurred on September 30, 2014.

**Potential Payments Upon Termination or Change in Control**

Name*	Payments and Benefits	Termination of Employment			Death or Disability (\$)	Change in Control (\$)
		Voluntary (\$)	Normal Retirement (\$)(5)	Without Cause (\$)		
Donald R. Horton	Severance Pay:					
	Cash					
	Equity					
	Annual Bonus <sup>(1)</sup>	4,885,110		4,885,110	4,885,110	4,885,110
	2014 Restricted Stock Units <sup>(2)</sup>	6,669,000		6,669,000	6,669,000	6,669,000
	2015 Restricted Stock Units <sup>(3)</sup>	2,736,014		2,736,014	2,736,014	2,736,014
	2016 Restricted Stock Units <sup>(4)</sup>	1,368,007		1,368,007	1,368,007	1,368,007
	Stock Options					
	Payments of SERP 2 Contributions	2,440,229		2,440,229	2,440,229	2,440,229
	<b>Total</b>	<b>18,098,360</b>		<b>18,098,360</b>	<b>18,098,360</b>	<b>18,098,360</b>
Donald J. Tomnitz	Severance Pay:					
	Cash					
	Equity					
	Annual Bonus <sup>(1)</sup>	4,885,110	4,885,110	4,885,110	4,885,110	4,885,110
	2014 Restricted Stock Units <sup>(2)</sup>	5,001,750	5,001,750	5,001,750	5,001,750	5,001,750
	2015 Restricted Stock Units <sup>(3)</sup>	2,052,000	2,052,000	2,052,000	2,052,000	2,052,000
	2016 Restricted Stock Units <sup>(4)</sup>	1,026,000	1,026,000	1,026,000	1,026,000	1,026,000
	Stock Options					
	Payments of SERP 2 Contributions	1,879,259	1,879,259	1,879,259	1,879,259	1,879,259
	<b>Total</b>	<b>14,844,119</b>	<b>14,844,119</b>	<b>14,844,119</b>	<b>14,844,119</b>	<b>14,844,119</b>
David V. Auld	Severance Pay:					
	Cash					
	Equity					
	Annual Bonus <sup>(1)</sup>	2,035,463		2,035,463	2,035,463	2,035,463
	Stock Options				1,484,760	1,484,760
	Payments of SERP 2 Contributions	1,054,728		1,054,728	1,054,728	1,054,728
<b>Total</b>	<b>3,090,191</b>		<b>3,090,191</b>	<b>4,574,951</b>	<b>4,574,951</b>	
Bill W. Wheat	Severance Pay:					
	Cash					
	Equity					
	Stock Options				1,484,760	1,484,760
	Payments of SERP 2 Contributions	568,553		568,553	568,553	568,553
<b>Total</b>	<b>568,553</b>		<b>568,553</b>	<b>2,053,313</b>	<b>2,053,313</b>	

- \* Stacey H. Dwyer is not listed in this table because she resigned from the Company in February 2014, and as a result she was not a named executive officer on September 30, 2014.



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- (1) Under the fiscal 2014 annual incentive bonus award, Mr. Horton, Mr. Tomnitz and Mr. Auld would have been entitled to receive the bonus earned during fiscal 2014 in the event of termination of employment or change in control occurring on September 30, 2014. For fiscal 2014, Mr. Horton and Mr. Tomnitz each earned \$4,885,110 and Mr. Auld earned \$2,035,463 which was paid subsequent to September 30, 2014. The annual incentive bonuses are discussed in more detail under the heading *2014 Fiscal Year Annual Incentive Bonus Results and Payout* on page 28.
- (2) Under the 2006 Stock Incentive Plan, Mr. Horton and Mr. Tomnitz were awarded a target number of 200,000 and 150,000 2014 Performance RSUs, respectively, for the performance period of October 1, 2011 through September 30, 2014. If any of the listed events had occurred at September 30, 2014, Mr. Horton and Mr. Tomnitz would have been entitled to the payout on the 2014 Performance RSUs in the amounts listed in the table. For each of Mr. Horton and Mr. Tomnitz, following September 30, 2014, the 2014 Performance RSUs earned were paid in common stock. The 2014 award is discussed in more detail under the headings *2014 Performance Restricted Stock Units Ranking Results and Vesting at September 30, 2014* on page 30.
- (3) Under the 2006 Stock Incentive Plan, Mr. Horton and Mr. Tomnitz were awarded a target number of 200,000 and 150,000 2015 Performance RSUs, respectively, for the performance period of October 1, 2012 through September 30, 2015. Pro-rata vesting may occur based on the number of months served from October 1, 2012 in the event of voluntary termination, normal retirement or without cause termination after completion of the performance period. With respect to death or disability, the 2015 Performance RSUs vest pro-rata based on time passed. Upon a change in control, the Committee may accelerate vesting of part or all of the 2015 Performance RSUs. With respect to an event of voluntary termination, normal retirement, without cause termination, death, disability or a change in control, the 2015 Performance RSUs are valued at \$20.52, the closing price of our stock on September 30, 2014. The value in the table reflects pro-rata vesting (two of three years completed) based on time passed as if an event of voluntary termination, normal retirement, without cause termination, death, disability or a change in control had occurred on September 30, 2014.
- (4) Under the 2006 Stock Incentive Plan, Mr. Horton and Mr. Tomnitz were awarded a target number of 200,000 and 150,000 2016 Performance RSUs, respectively, for the performance period of October 1, 2013 through September 30, 2016. Pro-rata vesting may occur based on the number of months served from October 1, 2013 in the event of voluntary termination, normal retirement or without cause termination after completion of the performance period. With respect to death or disability, the 2016 Performance RSUs vest pro-rata based on time passed. Upon a change in control, the Committee may accelerate vesting of part or all of the 2016 Performance RSUs. With respect to an event of voluntary termination, normal retirement, without cause termination, death, disability or a change in control, the 2016 Performance RSUs are valued at \$20.52, the closing price of our stock on September 30, 2014. The value in the table reflects pro-rata vesting (one of three years completed) based on time passed as if an event of voluntary termination, normal retirement, without cause termination, death, disability or a change in control had occurred on September 30, 2014. The 2016 Performance RSUs are discussed in more detail under the heading *2014 Fiscal Year Award of 2016 Performance Restricted Stock Units Potential Vesting at September 30, 2016* on page 34.
- (5) Because only one of our named executive officers has reached the normal retirement age (65 years old) under our applicable plans on September 30, 2014, we only included amounts under the *Normal Retirement* column for that one officer.

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**CERTAIN RELATIONSHIPS AND RELATED PERSON TRANSACTIONS**

We have a written Corporate Code of Business Conduct and Ethics. It requires that all directors and employees are expected to avoid relationships that present a potential or actual conflict between his or her personal interest and the interest of the Company. We generally review related-party transactions regarding our directors and executive officers in a similar manner as we review relationships that may give rise to a conflict of interest, provided there may be certain related-party transactions that may be ratified or approved. Generally, a *conflict of interest* exists whenever an individual's personal or private interests interfere or conflict in any way with the interests of the Company. A conflict situation can arise when a director or employee takes action or has personal interests that may make it difficult to perform Company work or make Company decisions objectively or effectively. Conflicts of interest may also arise when a director or employee, or member of his or her immediate family receives improper personal benefits as a result of his or her position with the Company, whether received from the Company or a third party.

To avoid conflicts of interest, or improper related-party transactions, each director or executive officer must disclose to the Company's Chief Legal Officer any transaction or relationship that reasonably could be expected to give rise to a conflict of interest or related-party transaction. The Chief Legal Officer and Corporate Compliance Officer then review the situation or transaction, and if necessary, reports the situation or transaction to the chairman of the Audit Committee. If it is determined that ratification or approval is necessary, the Audit Committee would be required to ratify or approve the relationship or transaction.

The following transaction was approved or ratified in accordance with the terms of the policy discussed above.

In July 2014, the Company purchased 39.13 acres of land from an entity in which Reagan Horton and Ryan Horton, two adult sons of Donald R. Horton, are interest holders. The land was located in an area where the Company had previously purchased other lots from an unrelated third-party. The total purchase price was \$390,000.

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

During our fiscal year ended September 30, 2014, D.R. Horton's Compensation Committee was composed of Barbara K. Allen, Brad S. Anderson, Michael R. Buchanan and Michael W. Hewatt, with Mr. Anderson serving as its Chairman. None of the members of the Compensation Committee has served the Company in any capacity other than as a member of the board or a member of a committee thereof.

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**PROPOSAL TWO**

**ADVISORY VOTE ON THE APPROVAL OF EXECUTIVE COMPENSATION**

Our stockholders are being asked to approve a non-binding advisory resolution on the compensation of our named executive officers, as disclosed in this Proxy Statement. Although this say-on-pay resolution is non-binding, our Board of Directors and Compensation Committee welcome your opinion and will consider the result of the vote when making future compensation decisions.

At our Annual Meeting of Stockholders held on January 23, 2014, our stockholders voted in favor of a resolution to approve, on an advisory basis, the compensation of the Company's named executive officers disclosed in the Compensation Discussion and Analysis, the Summary Compensation Table and the related compensation tables, notes and narrative in our Proxy Statement for the Company's 2014 Annual Meeting of Stockholders. Of the votes represented at the meeting, approximately 94.85% were voted in favor of the advisory vote on executive compensation.

At our Annual Meeting of Stockholders held on January 26, 2012, our stockholders elected to have an advisory vote on executive compensation every year. At our Annual Meeting of Stockholders to be held in January 2018, we intend to include a proposal to give our stockholders the option on whether to have an advisory vote on executive compensation every year, every second year or every third year.

We encourage you to read the Compensation Discussion and Analysis beginning on page 22 of this Proxy Statement, which describes in detail how our executive compensation policies and procedures operate and are designed to achieve our compensation objectives, as well as the Summary Compensation Table and other related compensation tables, notes and narrative, appearing on pages 42 through 52, which provide detailed information on the compensation of our named executive officers.

We believe that our current executive compensation program achieves an appropriate mix of short-term and long-term compensation incentives, reinforces the link between executive pay and the Company's long-term performance and stock value, and thereby aligns the interests of our named executive officers with those of stockholders.

In accordance with Section 14A of the Exchange Act, and as a matter of good corporate governance, we are asking stockholders to approve the following advisory resolution at the 2015 Annual Meeting:

**RESOLVED**, that the stockholders of D.R. Horton, Inc. (*the Company*) approve, on an advisory basis, the compensation of the Company's named executive officers disclosed in the Compensation Discussion and Analysis, the Summary Compensation Table and the related compensation tables, notes and narrative in the Proxy Statement for the Company's 2015 Annual Meeting of Stockholders.

**The Board of Directors Unanimously Recommends that Stockholders Vote FOR**

**Approval of the Advisory Resolution on Executive Compensation.**

**Table of Contents****INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS**

PricewaterhouseCoopers LLP, D.R. Horton's independent auditor for the fiscal year ended September 30, 2014, has been engaged by the Audit Committee to continue to serve through our fiscal year ending September 30, 2015. A representative of PricewaterhouseCoopers LLP is expected to be present at the 2015 Annual Meeting and will have an opportunity to make a statement and to respond to appropriate questions from stockholders.

**Audit Fees and All Other Fees**

The following table shows the fees paid or accrued by the Company for the audit and other services provided by PricewaterhouseCoopers LLP for fiscal years 2013 and 2014.

Fees	Fiscal Year Ended September 30,	
	2013 <sup>(3)</sup>	2014
Audit fees	\$ 1,758,425	\$ 1,613,000
Audit-related fees <sup>(1)</sup>	60,900	37,900
Tax fees		
All other fees		
Total <sup>(2)</sup>	\$ 1,819,325	\$ 1,650,900

- (1) Related primarily to audits of employee benefit plans and audit-related tax services.
- (2) Of the fees listed above, all of which were approved by the Audit Committee, none were approved based on waiver of pre-approval under Rule 2-01(c)(7)(i)(C) of Regulation S-X.
- (3) The amounts shown for fiscal 2013 have been revised to reflect additional fees paid for audit and audit-related services.
- Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services**

The Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. In recognition of this responsibility, the Audit Committee has established a policy to pre-approve audit and permissible non-audit services provided by the independent auditor.

In connection with the engagement of the independent auditor for fiscal 2015, the Audit Committee pre-approved the services listed below by category of service, including the pre-approval of fee limits. The Audit Committee's pre-approval process by category of service also includes a review of specific services to be performed and fees expected to be incurred within each category of service. The term of any pre-approval is 12 months from the date of the pre-approval, unless the Audit Committee specifically provides for a different period. During fiscal 2015, circumstances may arise when it may become necessary to engage the independent auditor for additional services not contemplated in the original pre-approval. In those instances, the Audit Committee requires separate pre-approval before engaging the independent auditor.

The services pre-approved by the Audit Committee, which may be performed by the independent auditor during our fiscal 2015, include the following:

*Audit Services* include audit work performed in the preparation of financial statements (including quarterly reviews), as well as work that generally only the independent auditor can reasonably be expected to provide, including comfort letters, statutory audits, and attest services and

consultation regarding financial accounting and/or reporting standards.

*Audit-Related Services* are for assurance and related services that are traditionally performed by the independent auditor, including due diligence related to mergers and acquisitions, employee benefit plan audits, and special procedures required to meet certain regulatory requirements.

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*Tax Services* include all services performed by the independent auditor's tax personnel except those services specifically related to the audit of the financial statements, and include fees in the areas of tax compliance, tax planning, and tax advice. The Audit Committee has not yet pre-approved any fee limits or specific Tax Services for fiscal 2015.

*All Other Fees* are those associated with permitted services not included in the other categories. The Company generally does not request such services from the independent auditor.

The Audit Committee may delegate pre-approval authority to one or more of its members. The member or members to whom such authority is delegated shall report any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee may not otherwise delegate its responsibilities to pre-approve services performed by the independent auditor to management.

## **Audit Committee Report**

The Audit Committee has reviewed and discussed with management D.R. Horton's audited consolidated financial statements for the fiscal year ended September 30, 2014. Further, the Audit Committee has discussed with D.R. Horton's independent auditor the matters required to be discussed by Auditing Standard No. 16, Communications with Audit Committees, including D.R. Horton's audited consolidated financial statements for the fiscal year ended September 30, 2014, the auditor's responsibility under generally accepted auditing standards, significant accounting policies, management's judgments and accounting estimates, any audit adjustments, other information in documents containing audited financial statements and other matters. Finally, the Audit Committee has received and reviewed the written disclosures and the letter from the independent auditor required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent auditor's communications with the Audit Committee concerning independence, and has discussed the auditor's independence with the auditor.

Based on its review and discussion described above, the Audit Committee has recommended to the Board of Directors that the audited consolidated financial statements for fiscal 2014 be included in D.R. Horton's Annual Report on Form 10-K for the fiscal year ended September 30, 2014. Further, the Audit Committee approved the engagement of PricewaterhouseCoopers LLP as D.R. Horton's independent auditor for the fiscal year ending September 30, 2015.

*AUDIT COMMITTEE:*

*Michael W. Hewatt, Committee Chairman*

*Barbara K. Allen*

*Brad S. Anderson*

*Michael R. Buchanan*

**Table of Contents****PROPOSAL THREE****APPROVAL OF THE D.R. HORTON, INC. 2006 STOCK INCENTIVE PLAN****(As Amended and Restated Effective as of December 11, 2014, subject to Stockholder Approval)****Overview**

At the Annual Meeting, stockholders will be presented with a proposal to approve the D.R. Horton, Inc. 2006 Stock Incentive Plan, as amended and restated (*the A&R Plan*). Our Compensation Committee approved the A&R Plan on December 11, 2014 (*the Effective Date*), subject to stockholder approval. The A&R Plan proposes to increase the number of shares of common stock reserved for issuance thereunder by 25,000,000, to extend the term until ten years from the Effective Date and to make certain ministerial changes.

For the A&R Plan to take effect, it must be approved by the Company's stockholders. If the A&R Plan is not approved by the Company's stockholders, the version of the 2006 Stock Incentive Plan, as amended and restated as of December 6, 2010 (*the Old Plan*), in effect immediately prior to December 11, 2014 will continue to operate according to its terms.

The following table sets forth certain information about the Old Plan and the A&R Plan:

Number of new shares being authorized	25,000,000
Number of shares available for future awards at December 1, 2014 under the Old Plan	3,542,060
Number of shares relating to outstanding stock options at December 1, 2014 under the Old Plan and 1991 Plan ( <i>hereafter defined</i> )	19,037,116
Number of shares outstanding at December 1, 2014 relating to awards of restricted stock and restricted stock units (full value awards)	1,627,868
Maximum option term	10 Years
Minimum exercise price (closing price of stock on date of grant)	100%
Weighted average remaining term of outstanding options	6.0 years
Weighted average exercise price of outstanding options	\$17.50

On December 1, 2014, the closing price of a share of the Company's common stock was \$25.10.

The potential dilution from the 25,000,000 share increase requested to be approved by stockholders is 6.8% of the Company's outstanding shares of common stock as of December 1, 2014. If the potential share request is approved, the Company's total potential dilution would increase from 6.6% of the Company's outstanding shares of common stock as of December 1, 2014 to 13.4%.

The Company oversees its long-term dilution by managing the number of shares subject to equity awards that it grants annually, commonly referred to as the burn rate (calculated by dividing all shares subject to equity awards granted during the fiscal year by the number of outstanding shares at the end of the fiscal year). The burn rate shows how rapidly a company is depleting its shares reserved for future issuance under its equity compensation plans. Over the past three fiscal years, the Company's burn rate has averaged 0.9% (1.2% in fiscal 2014, 1.3% in fiscal 2013 and 0.2% in fiscal 2012), while the industry group burn rate over the last three years averaged 2.70% (2.48% in 2014, 2.79% in 2013 and 2.84% in 2012). Our burn rate was 1.2% in fiscal 2014 and our industry group burn rate was 2.48% in 2014. The industry group burn rate was provided by Institutional Shareholder Services Inc., commonly known as ISS. We believe our significantly lower burn rate compared to our industry group's burn rate over the last three years show we have effectively managed our dilution in terms of burn rate compared to our industry.

When considering the number of additional shares to add to the A&R Plan, the Compensation Committee also reviewed, among other things, projected future share usage and projected future forfeitures. The projected future usage of shares for long-term incentive awards under the A&R Plan was reviewed under scenarios based on a variety of assumptions. Depending on assumptions, the 25,000,000 shares to be added to the A&R Plan, in combination with the remaining authorized shares and shares added back to the plan from forfeitures of awards previously granted, is expected to satisfy, assuming no significant acquisitions of other companies, the Company's equity compensation needs for approximately five years. The Compensation Committee is





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committed to effectively managing the number of shares reserved for issuance under the A&R Plan while minimizing stockholder dilution.

### **Best Practices**

We have developed our compensation policy with the goals of attracting, motivating and retaining experienced, qualified and productive personnel, rewarding superior performance and providing incentives that are based on our performance, as well as aligning the interests of our employees and stockholders. The A&R Plan is designed to help us achieve these objectives by providing us with the flexibility to grant stock options, stock appreciation rights, restricted stock and restricted stock units, any of which may be performance-based (*each, an Award* ).

In addition to helping us achieve these objectives, our Compensation Committee believes that the provisions of the A&R Plan reflect the Company's continued commitment to strong corporate governance practices in the interest of its stockholders in the following ways:

the A&R Plan prohibits, other than in connection with a change in the Company's capitalization, amending the terms of outstanding Awards to (a) reduce the exercise price of outstanding options or take any other action that is treated as a re-pricing under generally accepted accounting principles, or (b) at any time when the exercise price of an option is above the market value of a share of the Company's common stock, cancel, exchange, buyout or surrender outstanding options in exchange for cash, other awards or options or stock appreciation rights with an exercise price that is less than the exercise price of the original options, without stockholder approval;

the A&R Plan prohibits issuing stock options or stock appreciation rights with an exercise price below the fair market value of the Company's common stock on the date of grant;

in order to account for the difference in the value of a grant of stock options or stock appreciation rights versus a grant of full value shares, the A&R Plan provides a formula to determine the total number of shares of common stock available for future Awards; the availability will be reduced by one share for each one share issued in connection with a stock option or stock appreciation right and by 1.5 shares for each one share issued in connection with any other type of Award; and

to ensure that Awards are tied to performance or retention incentives, the A&R Plan provides that:

all grants of restricted stock or restricted stock units that are tied to the achievement of performance goals must have a minimum vesting period of one year;

all grants of restricted stock or restricted stock units that are tied to continued employment or the passage of time must have a minimum vesting period of three years, although the restricted stock or restricted stock units may vest on a pro-rata basis over such time period; and

all grants of incentive bonuses that are to be settled in shares of common stock must have a minimum performance period of one year and those that are to be settled in cash must have a minimum performance period of one quarter.

### **Section 162(m) of the Code**

The Compensation Committee believes that it is in the best interest of the Company and its stockholders to continue to provide equity incentive plans under which compensation awards can be made to the Company's executive officers that qualify for deductibility by the Company for federal income tax purposes. Accordingly, the A&R Plan has been structured in a manner such that awards granted under it can satisfy the requirements for performance-based compensation within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (*the Code* ), however, there can be no guarantee that amounts awarded under the A&R Plan will be treated as qualified performance-based compensation under Section 162(m). In general, under Section 162(m), in order for the Company to be able to deduct compensation in excess of \$1,000,000 paid in any one year to the Company's chief executive officer or any of the Company's three other most highly compensated executive



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officers (other than the Company's chief financial officer), such compensation must qualify as performance-based. One of the requirements of performance-based compensation for purposes of Section 162(m) is that the material terms of the performance goals under which compensation may be paid be disclosed to and approved by the Company's stockholders at least once every five years. For purposes of Section 162(m), the material terms include (i) the employees eligible to receive compensation, (ii) a description of the business criteria on which the performance goal is based and (iii) the maximum amount of compensation that can be paid to an employee under the performance goal. With respect to the various types of awards under the A&R Plan, each of these aspects is discussed below, and approval of the A&R Plan itself will constitute approval of each of these aspects of the A&R Plan for purposes of the approval requirements of Section 162(m).

### **Plan Summary**

The following summary of the material terms of the A&R Plan are qualified in their entirety by reference to the full text of the A&R Plan, which is set forth in *Appendix A* to this Proxy Statement.

#### ***Purpose***

The A&R Plan is intended to advance the interests of the Company by stimulating the efforts of employees, officers and non-employee directors and certain other service providers, in each case who are selected to be participants, by heightening the desire of such persons to continue in working toward and contributing to the success and progress of the Company and its subsidiaries. To this end, the A&R Plan provides for the grant of stock options, stock appreciation rights, restricted stock and restricted stock units, any of which may be performance-based, as well as performance-based incentive bonuses.

#### ***Administration***

The A&R Plan is administered by the Compensation Committee of the Board, or, if we do not have a Compensation Committee at any particular time, by the full Board (*in either case, the Administrator*). The Administrator may by resolution authorize one or more officers of the Company to grant Awards under the A&R Plan, which shall be on the terms and within the limits provided in the authorizing resolution to the extent required by the Delaware General Corporation Law. No such officer shall designate himself or herself or any executive officer or director of the Company as a recipient of any Awards granted under authority delegated to such officer. The Administrator may also delegate aspects of the day-to-day administration of the A&R Plan to one or more officers or employees of the Company or any of its subsidiaries or to one or more agents.

The Administrator has the authority to interpret and administer the A&R Plan to carry out the purposes of the A&R Plan. The Administrator has the authority to determine those persons eligible to receive Awards and to establish and interpret the terms and conditions of any Awards. The Administrator may also make exceptions to the provisions of any Awards. All determinations of the Administrator are final and binding.

#### ***Eligibility***

Awards may be made to any current or prospective officer or employee of the Company or any of its subsidiaries (including to any director who is also an employee), as well as to nonemployee directors and certain consultants or advisors to the Company or any of its subsidiaries. As of December 1, 2014, there were approximately 5,722 individuals eligible to participate in the Old Plan, including our 4 executive officers and 4 non-employee directors. The number of eligible participants may increase over time if the Company experiences growth.

#### ***Shares Subject to the Plan***

If this proposal is approved by the stockholders at the Annual Meeting, subject to adjustment for certain changes in the Company's capitalization, the aggregate number of shares of common stock issuable under the A&R Plan pursuant to Awards granted after December 1, 2014 will be 28,542,060, plus (i) any shares of common stock that were authorized for issuance under the D.R. Horton, Inc. 1991 Stock Incentive Plan (*the*

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*1991 Plan* ) as of the 2006 Annual Meeting that remained available for issuance under the 1991 Plan (not including shares of common stock that were subject to, as of the 2006 Annual Meeting, outstanding awards under the 1991 Plan or any shares of common stock that prior to the 2006 Annual Meeting were issued pursuant to awards granted under the 1991 Plan) and (ii) any shares of common stock subject to outstanding Awards under the 1991 Plan as of January 26, 2006 and the A&R Plan as of the Effective Date that on or after such date cease for any reason to be subject to such Awards (other than by reason of exercise or settlement of the Awards to the extent they are exercised for or settled in nonforfeitable shares of common stock); provided that any shares of common stock granted under options or stock appreciation rights will be counted against this limit on a one-for-one basis and any shares of common stock granted as Awards other than options or stock appreciation rights will be counted against this limit as 1.5 shares of common stock for every one share of common stock subject to such Award.

The aggregate number of shares of common stock issued under the A&R Plan at any time will equal only the number of shares of common stock actually issued upon exercise or settlement of an Award. Shares of common stock subject to an Award that has been cancelled, expired, forfeited or otherwise not issued under the Award and shares subject to an Award settled in cash instead of shares will again become available for grants of Awards under the A&R Plan; provided, however, that any shares that again become available grant pursuant to the foregoing will be added back on a one-for-one basis if such shares were subject to Awards of options or stock appreciation rights or added back as 1.5 shares for all shares granted as Awards other than options or stock appreciation rights. Shares of common stock that are used to pay the exercise price of the Award, delivered or withheld to pay withholding taxes, that were subject to a stock-settled stock appreciation right but not issued in such settlement or repurchased on the open market with the proceeds of an option exercise will be counted against the total number of shares of Common Stock available for grants of Awards.

The shares to be delivered under the A&R Plan may consist of, in whole or in part, shares of common stock that are authorized but unissued or shares that were reacquired by the Company, including, without limitation, shares purchased in the open market.

***Types of Awards***

The A&R Plan provides for grants of stock options, stock appreciation rights, restricted stock and restricted stock units, any of which may be performance-based, and performance-based incentive bonuses, whether granted singly or in combination, pursuant to which shares of common stock, cash or a combination thereof may be delivered to the Award recipient.

***Options.*** An option is the right to purchase shares of common stock at a future date at a specified exercise price. The Administrator may grant both nonqualified stock options and incentive stock options under the A&R Plan, although incentive stock options may only be granted to employees of the Company or any of its subsidiaries. The per share exercise price will be determined by the Administrator, but must be at least equal to the fair market value of the underlying shares of common stock on the date of grant. The Administrator determines the date after which options may be exercised in whole or in part and the expiration date of each option, which cannot be more than ten years from the date of grant; provided, however, the term of an option (other than an incentive stock option) will be automatically extended if, at the time of its scheduled expiration, the participant holding such option is prohibited by law or the Company's insider trading policy from exercising the option, which extension will expire on the 30<sup>th</sup> day following the date such prohibition no longer applies. Furthermore, in the case of an incentive stock option granted to a participant who holds more than 10% of the voting power of the Company, the exercise price must be at least 110% of the fair market value of the underlying shares of common stock on the date of grant and the expiration date cannot be more than five years from the date of grant. The exercise price of an option may be paid in shares of common stock, cash or a combination thereof, as determined by the Administrator, including an irrevocable commitment by a broker to pay the exercise price from the proceeds of a sale of shares issuable under the option, the delivery of previously owned shares or withholding of shares deliverable upon exercise. The terms of outstanding Awards may not be amended to reduce the exercise price of outstanding options or take any other action that is treated as re-pricing under generally accepted accounting principles or, at any time when the exercise price of an option is above the market value of a

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share of Company common stock, cancel, exchange, buyout or surrender outstanding options in exchange for cash, other awards or options or stock appreciation rights with an exercise price that is less than the exercise price of the original options without stockholder approval, other than in connection with a change in the Company's capitalization or other event or transaction as described below in *Change in Capitalization*. Participants will not have any voting rights and will not have rights to receive dividends or dividend equivalents in respect of an option or any shares subject to an option until the participant becomes the holder of record of such shares.

***Stock Appreciation Rights.*** A stock appreciation right ( *SAR* ) is a contractual right granted to the participant to receive, in cash, shares of common stock or a combination thereof, an amount equal to the appreciation of one share of common stock from the date of grant. Stock appreciation rights may be granted as freestanding Awards, or in tandem with other types of Awards. Unless otherwise determined by the Administrator, if a stock appreciation right is granted in tandem with another Award, the exercise price, vesting, exercisability, forfeiture and termination provisions applicable to the stock appreciation right will be identical to the exercise price, vesting, exercisability, forfeiture and termination provisions applicable to the other Award. All freestanding stock appreciation rights will be granted subject to the same terms and conditions applicable to options, as described above. The terms of outstanding Awards may not be amended to reduce the exercise price of outstanding SARs or take any other action that is treated as re-pricing under generally accepted accounting principles or, at any time when the exercise price of an SAR is above the market value of a share of Company common stock, cancel, exchange, buyout or surrender outstanding SARs in exchange for cash, other awards or options or stock appreciation rights with an exercise price that is less than the exercise price of the original SARs without stockholder approval, other than in connection with a change in the Company's capitalization or other event or transaction as described below in *Change in Capitalization*. Participants will not have any voting rights and will not have rights to receive dividends or dividend equivalents in respect of an SAR or any shares subject to an SAR until the participant becomes the holder of record of such shares.

***Restricted Stock and Restricted Stock Units.*** A restricted stock award involves an immediate transfer of ownership of a fixed number of shares of common stock to the participant, although the shares are subject to a risk of forfeiture or to other conditions or restrictions during specified periods of time. The participant may be entitled to voting, dividend and other ownership rights in such shares at the discretion of the Administrator although dividends, if any, on any performance-based awards will be subject to the same performance-based vesting conditions as the underlying shares. A restricted stock unit is an award denominated in units of shares of common stock that is subject to such terms and conditions as the Administrator deems appropriate. For each restricted stock unit, a participant will be entitled to receive (assuming all terms and conditions are met) either shares of common stock or a cash amount calculated with reference to the value of a share of common stock. If the vesting schedule of restricted stock or restricted stock units is based on performance criteria, the performance period must be at least one year, whereas if the vesting schedule is based upon continued employment and/or the passage of time, the vesting period must be at least three years, although pro-rata vesting during that time period is permitted (thus, for example, the Administrator could provide that an Award of restricted stock will vest in three equal installments on the first, second and third anniversaries of the date of grant). The Administrator may include provisions in the Award agreement that accelerate the vesting of restricted stock or restricted stock units in the event of a participant's death, disability, retirement or in connection with a change of control of the Company. Additionally, the Administrator has discretion not to impose vesting restrictions on Awards issued in payment or settlement of compensation that has already been earned by the participant.

***Incentive Bonuses.*** An incentive bonus is a bonus opportunity to earn a right to a future payment based on the satisfaction of performance criteria established by the Administrator and included in the Award agreement. If an incentive bonus is to be paid in shares of common stock, the performance period must be at least one year, whereas if an incentive bonus is to be paid in cash, the performance period must be at least one calendar quarter.

### ***Substitute Awards***

If the Company or any of its subsidiaries acquires or merges or combines with another entity, the Company may grant Awards in assumption of, or in substitution or exchange for, awards previously granted or promised ( *Substitute Awards* ). Substitute Awards will not reduce the number of shares of common stock authorized for

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issuance under the A&R Plan or authorized for grant to a participant in any calendar year. The exercise price of a Substitute Award may be less than the fair market value of the underlying shares of common stock on the date of grant if the exercise price is based on a formula contained in the original option agreement or the purchase or merger agreement. The Administrator may provide for the vesting of a Substitute Award sooner than required for other Awards. In addition, if the entity acquired by the Company or any of its subsidiaries or with which the Company or any of its subsidiaries merges or combines has shares available under a pre-existing plan approved by its stockholders, the Company may grant awards to individuals who were employees, directors, consultants or advisors of the other entity under such other entity's pre-existing plan and such grants of awards will not reduce the amount of shares of common stock available for issuance under the A&R Plan.

### ***Qualifying Performance-Based Compensation***

The Administrator may establish performance criteria and levels of achievement versus such criteria that will determine the number of shares to be granted, retained, vested, issued or issuable under or in settlement of or the amount payable pursuant to an Award. The criteria may be based on qualifying performance criteria (described below) or other standards of financial performance or personal performance evaluations. In addition, if the measure for the Award is one or more of the qualifying performance criteria, the Administrator may specify that all or a portion of the Award is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code. Section 162(m) of the Code limits the Company's federal income tax deduction for compensation paid to the Company's chief executive officer or any of the Company's three other most highly compensated executive officers (other than the Company's chief financial officer). The limit is \$1,000,000 per officer per year, with certain exceptions. However, the deductibility limit does not apply to performance-based compensation if the qualifying performance criteria are approved in advance by the Company's stockholders. Stockholder approval of this proposal will constitute stockholder approval of the qualifying performance criteria for purposes of Section 162(m) of the Code. The rules and regulations promulgated under Section 162(m) of the Code are complex, however, and may change from time to time, sometimes with retroactive effect. As such, there can be no guarantee that any award intended to qualify as performance-based compensation under Section 162(m) of the Code will so qualify.

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For this purpose, the qualifying performance criteria will be any one or more of the following performance criteria, either individually, alternatively or in any combination, applied to either the Company as a whole or to a business unit or subsidiary, either individually, alternatively or in any combination, and measured either quarterly, annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years' results or to a designated comparison group, calculated in accordance with general accepted accounting principles or not calculated in accordance with generally accepted accounting principles, in each case as specified by the Administrator:

gross profit or gross profit percentage;	land, lot or inventory improvement;	operating profit, net operating profit or economic profit;
income or pre-tax income percentage;	selling, general and administrative expense improvement or containment;	gross margin, operating margin or profit margin;
stockholder return or total stockholder return;	revenue;	backlog;
return on capital (including return on total capital or return on invested capital);	sales or net sales;	market capitalization;
return on investment;	operating revenue;	market share improvement;
return on assets or net assets;	operating income or pre-tax profit;	economic value added;
return on equity;	cash from operations;	customer service;
return on operating revenue or return on operating assets;	cash flow (before or after dividends);	debt leverage (debt to capital); or
stock price;	general and administrative expenses;	operating ratio.
earnings per share (including earnings before interest, taxes, depreciation and amortization);	income, pre-tax income or net income.	

To the extent consistent with Section 162(m) of the Code, the Administrator may appropriately adjust any evaluation of performance under qualifying performance criteria to exclude any of the following events that occurs during a performance period:

asset write-downs or asset impairments;

litigation, claims, judgments or settlements;

the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results;

accruals for reorganization and restructuring programs or accruals for any amounts for payments under the A&R Plan or any other compensation arrangement maintained by the Company; and

any extraordinary, unusual, non-recurring or non-comparable items

as determined in accordance with generally accepted accounting principles;

as identified in the Company's financial statements or notes to the financial statements;

as described in management's discussion and analysis of financial condition and results of operations appearing in the Company's periodic reports filed with the SEC; or



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publicly announced by the Company in a press release or conference call relating to the Company's results of operations or financial condition for a completed quarterly or annual fiscal period.

The Administrator must certify the extent to which any qualifying performance criteria have been satisfied, and the amount payable as a result thereof, prior to payment, settlement or vesting of any Award that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code. Notwithstanding satisfaction of any performance criteria, the number of shares issued under or the amount paid under an Award may, to the extent specified in the Award agreement, be reduced (but not increased) by the Administrator on the basis of such further considerations as the Administrator in its sole discretion may determine.

### ***Limitations of Awards***

The A&R Plan includes the following limitations on the number of shares of common stock underlying Awards and the amount of cash payable under an incentive bonus that can be granted to any one participant, subject to adjustment for certain changes in our capitalization:

participants may not receive Awards, denominated in shares, with respect to more than 750,000 shares of common stock during any calendar year, which limitation does not include any shares underlying a tandem stock appreciation right;

participants may not receive an incentive bonus payment for any performance period, denominated in cash, that is intended to satisfy the requirements of performance-based compensation under Section 162(m) of the Code that exceeds 2% of the Company's consolidated pre-tax income for such performance period;

nonemployee directors may not receive Awards with respect to more than 15,000 shares of common stock during any calendar year, which limit will not include any shares underlying tandem stock appreciation rights;

the aggregate number of shares of common stock that may be issued pursuant to the exercise of incentive stock options granted under the A&R Plan may not exceed 28,542,060 after December 1, 2014; and

consultants or advisors may not receive Awards with respect to more than 300,000 shares of common stock during the life of the A&R Plan.

Awards may not be granted under the A&R Plan after ten years from the Effective Date.

### ***Transferability Restrictions***

Except as otherwise permitted by the Administrator, participants generally may not sell, transfer, pledge, assign or otherwise alienate or hypothecate Awards granted under the A&R Plan other than by will or the laws of descent and distribution, and each option and stock appreciation right is generally exercisable only by a participant during his or her lifetime.

### ***Termination of Employment***

The Administrator will determine and include in the Award agreement the terms and conditions applicable to an Award following a participant's termination of employment with the Company or any of its subsidiaries.

### ***Change in Capitalization***

The Administrator has discretion to adjust the number and kind of shares available for issuance under the A&R Plan and the number and kind of shares subject to the limitations described above in *Limitations of Awards* in the event of a reorganization, reclassification, combination or exchange of shares, repurchase of shares, stock split, reverse stock split, spin-off, dividend or other distribution of securities, property or cash (other than regular, quarterly cash dividends), or any other event or transaction that affects the number or kind of shares of the Company outstanding. The Administrator may also adjust the exercise price, number or kind of shares subject to individual Awards and other terms to

reflect the foregoing events.

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In the event of a change in capitalization caused by a change of control, merger, consolidation or otherwise, the Administrator has discretion to determine the appropriate adjustment, if any, to be effected. For example, the Administrator has discretion to (i) provide for the assumption or substitution of, or adjustment to, each outstanding Award, (ii) accelerate the vesting of, or termination of any restrictions on, outstanding Awards, (iii) provide for cancellation of accelerated Awards that are not exercised within a time period prescribed by the Administrator or (iv) provide for the cancellation of outstanding Awards in exchange for a cash payment to the holders of such Awards.

No fractional shares will be issued in connection with a change in capitalization. Instead, the number of shares of common stock subject to an Award will be rounded down to the next lowest whole share.

### ***Amendment or Termination of the A&R Plan***

The Board or Compensation Committee may amend, alter or discontinue the A&R Plan, and the Administrator may amend or alter any Award agreement. However, other than in connection with a change in the Company's capitalization as described above in *Change in Capitalization*, no amendment may be made without stockholder approval if such amendment would:

increase the maximum number of shares of common stock for which Awards may be granted under the A&R Plan;

reduce the exercise price of future issuances of options or stock appreciation rights to below the fair market value of a share of common stock on the date of grant;

reduce the exercise price of outstanding options or take any other action that is treated as re-pricing under generally accepted accounting principles or, at any time when the exercise price of an option is above the market value of a share of Company common stock, cancel, exchange, buyout or surrender outstanding options in exchange for cash, other awards or options or stock appreciation rights with an exercise price that is less than the exercise price of the original options;

extend the term of the A&R Plan;

change the class of persons eligible to be participants in the A&R Plan;

otherwise amend the A&R Plan in any way that would require stockholder approval by law or under the New York Stock Exchange listing requirements; or

increase the limitations for non-employee directors and those applicable to any one participant in a calendar year (or other performance period) described in *Limitations of Awards*.

### ***U.S. Federal Income Tax Consequences***

The following is a summary of the material U.S. federal income tax consequences to the Company and to recipients of stock options and stock appreciation rights and other Awards under the A&R Plan. The summary is based on the United States Internal Revenue Code and the U.S. Treasury regulations promulgated under the Code in effect as of the date of this proxy statement, all of which are subject to change with retroactive effect. The summary is not intended to be a complete analysis or discussion of all potential tax consequences that may be important to recipients of Awards under the A&R Plan. The laws governing the tax aspects of these awards are highly technical, and such laws are subject to change. Different tax rules may apply to specific participants and transactions under the A&R Plan, particularly in jurisdictions outside the United States.

### ***Nonqualified Stock Options and Stock Appreciation Rights***

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The recipient will not have any income at the time a nonqualified stock option or a SAR is granted nor will the Company be entitled to a deduction at that time. When a nonqualified option is exercised, the optionee generally will recognize ordinary income (whether the option price is paid in cash or by delivery or surrender of shares of common stock), in an amount equal to the excess of the fair market value of the shares to which the option exercise pertains over the option exercise price. When an SAR is exercised, the holder will recognize ordinary income equal to the sum of (a) the gross cash proceeds payable and (b) the fair market value on the

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exercise date of any shares received. The Company will be entitled to a corresponding deduction with respect to a nonqualified stock option or SAR equal to the ordinary income recognized by the optionee or holder of the SAR, provided that the deduction is not disallowed by Section 162(m) or otherwise limited by the Code.

***Incentive Stock Options ( ISOs )***

A recipient will not have any income at the time an ISO is granted or have regular taxable income at the time the ISO is exercised. However, the excess of the fair market value of the shares at the time of exercise over the option exercise price will be a preference item that could create an alternative minimum tax liability for the optionee. Such alternative minimum tax may be payable even though the optionee receives no cash upon the exercise of the ISO with which to pay such tax. If the optionee disposes of the shares acquired on exercise of an ISO after the later of two years after the grant of the ISO and one year after exercise of the ISO, the gain recognized by the optionee (i.e., the excess of the proceeds received over the option exercise price), if any, will be long-term capital gain eligible for favorable tax rates under the Code. Conversely, if the optionee disposes of the shares within two years of the grant of the ISO or within one year of exercise of the ISO, the disposition will generally be a disqualifying disposition, and the optionee will recognize ordinary income in the year of the disqualifying disposition equal to the lesser of (i) the excess of the fair market value of the stock on the date of exercise over the option exercise price and (ii) the excess of the amount received for the shares over the option exercise price. The balance of the gain or loss, if any, will be long-term or short-term capital gain, depending on how long the shares were held. The Company is not entitled to a deduction as the result of the grant or exercise of an ISO. However, if the optionee recognizes ordinary income as a result of a disqualifying disposition, the Company will be entitled to a corresponding deduction equal to the amount of ordinary income recognized by the optionee, provided that the deduction is not disallowed by Section 162(m) or otherwise limited by the Code. We intend that awards granted under the A&R Plan comply with, or are otherwise exempt from, Section 409A of the Code.

***Restricted Stock***

A participant will not recognize income upon the grant of restricted stock. If the participant makes an election under Section 83(b) Code within 30 days after receiving the shares of restricted stock, however, he or she will recognize ordinary income in the year of receipt in an amount equal to the excess of the fair market value of such shares (determined without regard to the restrictions imposed by the A&R Plan) at the time of transfer over any amount paid by the participant therefor. Then, upon the sale of such stock, the difference between the fair market value at the time of transfer and the net proceeds of sale will generally be taxed as capital gain or loss (long-term or short-term, depending on the holding period). If a participant makes a Section 83(b) election with respect to shares of common stock that are subsequently forfeited, he or she will not be entitled to deduct any amount previously included in income by reason of such election. If a participant does not make a Section 83(b) election, the participant will recognize ordinary income in the year or years in which the award of restricted stock vests and the restrictions imposed by the A&R Plan on the Award terminate, in an amount equal to the excess, if any, of the fair market value of such shares on the date the restrictions expire or are removed over any amount paid by the participant. If a Section 83(b) election has not been made, any dividends received with respect to shares of common stock subject to restrictions will be treated as additional compensation income and not as dividend income.

***Restricted Stock Units***

A participant generally will not recognize income upon the grant of an Award of restricted stock units. Unless the participant has made a deferral election that satisfies the requirements of Code Section 409A, the participant will recognize ordinary income in the year or years in which the restricted stock units vest and the restrictions imposed by the A&R Plan on the Award terminate in an amount equal to the excess, if any, of the fair market value of the shares of common stock on the date the restrictions expire or are removed over any amount paid by the participant for such shares. If a valid deferral election has been made, the participant will recognize ordinary income in the year the restricted stock unit is paid to him, in an amount equal to the excess, if any, of the fair market value of the shares of common stock on the date of payment over the amount paid by the participant for such shares.

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**Table of Contents*****Incentive Bonuses***

A participant generally will not recognize income upon the grant of an Award of an incentive bonus. The participant will recognize ordinary income in the year of settlement in an amount equal to the cash received and the fair market value of any shares of common stock received.

***Withholding Taxes***

Generally, the Company will be required to withhold applicable taxes with respect to any ordinary income recognized by a participant in connection with Awards granted under the A&R Plan. The Administrator may permit a participant to pay withholding taxes through the mandatory or elective sale of shares of common stock, by electing to have the Company withhold a portion of the shares that would otherwise be issued upon exercise of an Award or by tendering shares already owned by the participant.

***Section 162(m) Awards***

The right of a grantee to exercise or receive a grant or settlement of any award, and the timing thereof, may be subject to such performance conditions as may be specified by the Compensation Committee. The Compensation Committee may use such business criteria and other measures of performance as it may deem appropriate in establishing any performance conditions, and may exercise its discretion to reduce the amounts payable under any award subject to performance conditions, except as limited by the A&R Plan in the case of a performance award or annual incentive award intended to qualify under Code Section 162(m). If and to the extent required under Code Section 162(m), any power or authority relating to a performance award or annual incentive award intended to qualify under Code Section 162(m), shall be exercised by the Compensation Committee and not the Board of Directors.

It is the intent of the Company that performance awards and annual incentive awards granted to persons who are designated by the Compensation Committee as likely to be covered employees within the meaning of Code Section 162(m) and regulations thereunder (generally including the chief executive officer and the three most other highly-compensated executive officers other than the chief financial officer) shall, if so designated by the Compensation Committee, constitute qualified performance-based compensation within the meaning of Code Section 162(m) and regulations thereunder. The rules and regulations promulgated under Section 162(m), however, are complicated and subject to change from time to time, sometimes with retroactive effect. In addition, a number of requirements must be met in order for particular compensation to so qualify. As such, there can be no assurance that any compensation awarded or paid under the A&R Plan will be deductible under all circumstances.

**General Matters**

The Company will generally be entitled to a tax deduction corresponding in amount and time to the participant's recognition of ordinary income in the circumstances described above, provided, among other things, that such deduction meets the test of reasonableness and is an ordinary and necessary business expense. However, in connection with a change in control of the Company, and depending upon the terms and conditions of Awards granted under the A&R Plan and upon the individual circumstances of the participants, certain amounts with respect to Awards granted under the A&R Plan may constitute excess parachute payments under the golden parachute provisions of Section 280G of the Code. Under these provisions, a participant will be subject to a 20% excise tax on any excess parachute payment and the Company will be denied any deduction with respect to such payment.

**New Plan Benefits**

The benefits that will be awarded or paid in the future under the A&R Plan are not currently determinable. Such awards are within the discretion of the Compensation Committee, and the Compensation Committee has not determined future awards or who might receive them. Information about awards granted in fiscal 2014 under the Old Plan to the Company's named executive officers can be found in the table under the heading *Grants of Plan-Based Awards* on page 44 of this Proxy Statement. As of December 1, 2014, the closing price of a share of the Company's common stock was \$25.10.

**Table of Contents****Existing Plan Benefits**

Pursuant to SEC rules, the following table sets forth information with respect to the number of shares underlying grants of all types of awards under the Old Plan and 1991 Plan that are outstanding at December 1, 2014 that count against the plan's maximum share authorization.

Name and Position	Total Number of Shares Underlying Award Grants
Donald R. Horton <i>Chairman</i>	2,440,835
David V. Auld <i>Chief Executive Officer</i>	435,000
Bill W. Wheat <i>Chief Financial Officer</i>	440,500
Michael J. Murray <i>Chief Operating Officer</i>	367,500
All current executive officers as a group	3,683,835
All non-employee directors as a group	190,835
All employees as a group (excluding executive officers and non-employee directors)	16,790,314

**Securities Authorized for Issuance under Equity Compensation Plans**

The following table summarizes our equity compensation plans as of September 30, 2014:

Plan Category	(a) Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
Equity compensation plans approved by stockholders	20,558,812 <sup>(1)</sup>	\$ 16.46 <sup>(2)</sup>	7,249,675 <sup>(3)</sup>
Equity compensation plans not approved by stockholders		n/a	
<b>Total</b>	<b>20,558,812</b>	<b>\$ 16.46</b>	<b>7,249,675</b>

(1) Amount includes outstanding stock option and restricted stock unit awards. The number of outstanding restricted stock unit awards is based on the target number of units granted to certain executive officers, other key employees and non-management directors.

(2) Amount reflects the weighted average exercise price with respect to outstanding stock options and does not take into account outstanding restricted stock units, which do not have an exercise price.

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- (3) Amount includes 3,498,705 shares reserved for issuance under the Company's Employee Stock Purchase Plan. Under the Employee Stock Purchase Plan, employees purchased 77,216 shares of common stock in fiscal 2014.



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**Securities Registration**

We intend to register the shares of common stock available for issuance under the A&R Plan under a Registration Statement on Form S-8 to be filed with the SEC upon approval of the A&R Plan by our stockholders.

**The Board of Directors has Approved Proposal Three to Adopt the D.R. Horton, Inc.**

**A&R Plan as Attached as *Appendix A*,**

**and the Board of Directors Unanimously Recommends that Stockholders**

**Vote FOR the Adoption of Proposal Three.**

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**PROPOSAL FOUR**

**RATIFICATION OF APPOINTMENT OF INDEPENDENT**

**REGISTERED PUBLIC ACCOUNTING FIRM**

The Audit Committee has appointed PricewaterhouseCoopers LLP as our independent registered public accounting firm to audit our consolidated financial statements for our fiscal year ending September 30, 2015. During fiscal 2014, PricewaterhouseCoopers LLP served as our independent registered public accounting firm and also provided certain other audit-related services, as further discussed above under the heading *Audit Fees and All Other Fees* on page 55. A representative of PricewaterhouseCoopers LLP is expected to attend the 2015 Annual Meeting, be available to respond to appropriate questions and, if he or she desires, make a statement.

Although we are not required to do so, we are seeking stockholder ratification of PricewaterhouseCoopers LLP's appointment as our independent registered public accounting firm. If PricewaterhouseCoopers LLP's appointment is not ratified, the Audit Committee will reconsider whether to retain PricewaterhouseCoopers LLP, but still may retain them. Even if the appointment of PricewaterhouseCoopers LLP is ratified, the Audit Committee, in its discretion, may change the appointment at any time during the year if it determines that such a change would be in our and our stockholders' best interests.

**Vote Required**

Approval of the ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for our fiscal year ending September 30, 2015 requires the affirmative vote of the majority of shares of common stock present or represented, and entitled to vote thereon, at the 2015 Annual Meeting.

**The Board of Directors Unanimously Recommends that Stockholders Vote FOR the Ratification of the Appointment of PricewaterhouseCoopers LLP as our Independent Registered Public Accounting Firm for our Fiscal Year Ending September 30, 2015.**

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**SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Exchange Act, requires D.R. Horton's directors, certain of its officers, and persons who own more than 10% of a registered class of D.R. Horton's equity securities to file reports of ownership and changes in ownership with the SEC. Such officers, directors and greater than 10% stockholders are required by SEC regulations to furnish D.R. Horton with copies of all forms they file pursuant to Section 16(a). Based solely on its review of the copies of such forms received by it and on written representations from certain reporting persons that no Form 5 reports were required for those persons, D.R. Horton believes that all filing requirements applicable to its officers, directors and greater than 10% beneficial owners were complied with during the year ended September 30, 2014 on a timely basis, except that an amended Form 3 was filed for Barbara K. Allen to report an additional 1,050 shares of the Company's common stock she purchased before becoming a director of the Company.

**STOCKHOLDER PROPOSALS FOR 2016 ANNUAL MEETING**

Any stockholder who intends to present a proposal for action at D.R. Horton's 2016 Annual Meeting of Stockholders and to have D.R. Horton include such proposal in its proxy soliciting materials pursuant to Rule 14a-8 under the Exchange Act must deliver a copy of the proposal to D.R. Horton not later than August 19, 2015.

In addition, apart from the Rule 14a-8 process as described below, the Bylaws of D.R. Horton provide that any stockholder intending to propose any business at our 2016 Annual Meeting must submit written notice of that proposal in a timely manner to Corporate Counsel of D.R. Horton for such proposal to be acted upon at the meeting of stockholders. To be timely, a stockholder's notice for our 2016 Annual Meeting must be delivered to, or mailed and received at, the principal executive offices of D.R. Horton not later than the close of business on October 25, 2015 and not earlier than the close of business on September 25, 2015. In the event that the date of the 2016 Annual Meeting is changed by more than 30 calendar days from the anniversary date of the 2015 Annual Meeting, notice by the stockholder to be timely must be so delivered not earlier than the close of business on the 120th calendar day prior to such meeting and not later than the close of business on the later of the 90th calendar day prior to such meeting or the 10th calendar day following the day on which public disclosure of the date of such meeting is made. In no event shall public disclosure of an adjournment or postponement of an annual meeting commence a new time period (or extend any time period) for the giving of a stockholder's notice as described above. The notice must include the information specified in our Bylaws, including information concerning the nominee or the proposal, and the stockholder and the beneficial owner, as the case may be. We will not entertain any such proposals at the annual meeting that do not meet the requirements set forth in our Bylaws. The Bylaws provide that the foregoing notice requirements do not apply to a proposal proposed to be made by a stockholder if the stockholder has notified the Company of his or her intention to present a proposal at the 2016 Annual Meeting pursuant to and in compliance with Rule 14a-8, or any other rule promulgated under Section 14 of the Exchange Act and such proposal is included in the Company's proxy statement for such annual meeting.

**REQUESTING DOCUMENTS FROM THE COMPANY**

On our website, at [www.drhorton.com](http://www.drhorton.com), under the Investor Relations and Corporate Governance links, you will find the following: (i) Corporate Governance Principles, (ii) Audit Committee Charter, (iii) Compensation Committee Charter, (iv) Nominating and Governance Committee Charter, (v) Code of Ethical Conduct for the CEO, CFO, and Senior Financial Officers, (vi) Complaint Procedures for Accounting, Internal Control, Auditing and Financial Matters and Complaint Procedures for Employee Matters, and (vii) Corporate Code of Business Conduct and Ethics for Employees and Directors. **You may obtain a copy of any of these documents at no charge through our website or by contacting us for a printed set. In addition, a copy of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014, including the financial statements and the financial statement schedules included therein, is available without charge. The exhibits of the Annual Report on Form 10-K are available upon payment of charges that approximate our cost of reproduction.** You may contact us for these purposes at: Attention: Thomas B. Montano, Corporate Counsel, D.R. Horton, Inc., 301 Commerce Street, Suite 500, Fort Worth, TX 76102, (817) 390-8200 or e-mail: [tbmontano@drhorton.com](mailto:tbmontano@drhorton.com).

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**OTHER MATTERS**

Management knows of no other matters to be voted upon at the 2015 Annual Meeting. If any other matter is properly brought before the 2015 Annual Meeting, it is the intention of the persons named as proxies in the form of proxy to vote in their discretion upon such matters in accordance with their judgment. The persons named as proxies are Donald R. Horton, Chairman, and David V. Auld, President and Chief Executive Officer.

You are urged to sign, date and return the enclosed proxy in the envelope provided. No postage is required if the envelope is mailed from within the United States. If you subsequently decide to attend the 2015 Annual Meeting and wish to vote your shares in person, you may do so. Your cooperation in giving this matter your prompt attention is appreciated.

By Order of the Board of Directors,

THOMAS B. MONTANO  
*Vice President and Assistant Secretary*

Fort Worth, Texas

December 17, 2014

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**APPENDIX A**

**D.R. HORTON, INC.**

**2006 STOCK INCENTIVE PLAN**

**(As Amended & Restated Effective as of December 11, 2014)**

**1. Purpose**

The purpose of the D.R. Horton, Inc. 2006 Stock Incentive Plan (As Amended and Restated Effective as of December 11, 2014) (the **Plan**) is to advance the interests of D.R. Horton, Inc. (the **Company**) by stimulating the efforts of employees, officers and, to the extent provided by Sections 5(e) and (f), non-employee directors and certain other service providers, in each case who are selected to be participants, by heightening the desire of such persons to continue in working toward and contributing to the success and progress of the Company. The Plan, when originally adopted, superseded the Company's 1991 Stock Incentive Plan with respect to future awards, and provides for the grant of Incentive and Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock and Restricted Stock Units, any of which may be performance-based, and for Incentive Bonuses, which may be paid in cash or stock or a combination thereof, as determined by the Administrator.

**2. Definitions**

As used in the Plan, the following terms shall have the meanings set forth below:

- (a) **Administrator** means the Administrator of the Plan in accordance with Section 17.
- (b) **Award** means an Incentive Stock Option, Nonqualified Stock Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit or Incentive Bonus granted to a Participant pursuant to the provisions of the Plan, any of which the Administrator may structure to qualify in whole or in part as a Performance Award.
- (c) **Award Agreement** means a written agreement or other instrument, which may be transmitted electronically, at the Company's Administrator's discretion, as may be approved from time to time by the Administrator implementing the grant of each Award. An Agreement may be in the form of an agreement to be executed by both the Participant and the Company (or an authorized representative of the Company) or certificates, notices or similar instruments as approved by the Administrator.
- (d) **Board** means the board of directors of the Company.
- (e) **Change in Control** means the occurrence of any of the following events:
  - (1) The consummation of a merger, consolidation or reorganization of the Company into or with another corporation or other legal person if the stockholders of the Company, immediately before such merger, consolidation or reorganization, do not, immediately following such merger, consolidation or reorganization, then own directly or indirectly, more than 50% of the combined voting power of the then-outstanding voting securities of the corporation or other legal person resulting from such merger, consolidation or reorganization in substantially the same proportion as their ownership of Voting Securities (as hereinafter defined) immediately prior to such merger, consolidation or reorganization;
  - (2) The Company sells all or substantially all of its assets to another corporation or other legal person, or there is a complete liquidation or dissolution of the Company;
  - (3) Any person (as the term **person** is used in Section 13(d)(3) or Section 14(d)(2) of the Exchange Act) has become the beneficial owner (as the term **beneficial owner** is defined under Rule 13d-3 or any successor rule or regulation promulgated under the Exchange Act) of securities representing 20 % or more of the

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combined voting power of the then-outstanding voting securities of the Company ( **Voting Securities** ) (computed in accordance with the standards for the computation of total percentage ownership for the purposes of Schedule 13D or Schedule 14D-I or any successor schedule, form or report)); excluding, however, the following: any acquisition by the Company, any Subsidiary or an employee benefit plan or related trust of the Company or any Subsidiary; or

- (4) During any two (2) year period, a majority of the members of the Board serving at the date of the most recent approval of this Plan by stockholders is replaced by members of the Board who are not nominated and approved by the Board.
- (f) **Code** means the Internal Revenue Code of 1986, as amended from time to time, and the rulings and regulations issues thereunder.
- (g) **Company** means D.R. Horton, Inc., a Delaware corporation.
- (h) **Exchange Act** means the Securities Exchange Act of 1934, as amended.
- (i) **Incentive Bonus** means a bonus opportunity awarded under Section 9 pursuant to which a Participant may become entitled to receive an amount based on satisfaction of such performance criteria as are specified in the Award Agreement.
- (j) **Incentive Stock Option** means a stock option that is intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.
- (k) **Nonemployee Director** means each person who is, or is elected to be, a member of the Board and who is not an employee of the Company or any Subsidiary.
- (l) **Nonqualified Stock Option** means a stock option that is not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.
- (m) **Option** means an Incentive Stock Option and/or a Nonqualified Stock Option granted pursuant to Section 6.
- (n) **Participant** means any individual described in Section 3 to whom Awards have been granted from time to time by the Administrator and any authorized transferee of such individual.
- (o) **Performance Award** means an Award, the grant, issuance, retention, vesting or settlement of which is subject to satisfaction of one or more Qualifying Performance Criteria established pursuant to Section 13.
- (p) **Plan** means D.R. Horton, Inc. 2006 Stock Incentive Plan (As Amended & Restated Effective as of December 11, 2014), as set forth herein and as amended from time to time.
- (q) **Prior Plan** means D.R. Horton, Inc. 1991 Stock Incentive Plan, as amended and restated on February 21, 2002.
- (r) **Qualifying Performance Criteria** has the meaning set forth in Section 13(b).
- (s) **Restricted Stock** means Shares granted pursuant to Section 8.
- (t) **Restricted Stock Unit** means an Award granted to a Participant pursuant to Section 8 pursuant to which Shares or cash in lieu thereof may be issued in the future.
- (u) **Service Provider** means a consultant or advisor to the Company or any Subsidiary who (i) is a natural person, (ii) provides bona fide services to the Company or any Subsidiary, (iii) provides services other

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than in connection with the offer or sale of securities in a capital-raising transaction, and (iv) does not directly or indirectly promote or maintain a market for the Company's securities, in each case, within the meaning of the General Instructions to Form S-8 under the Securities Act of 1933, as amended.

(v) **Share** means a share of the Company's common stock, par value \$.01, subject to adjustment as provided in Section 12.

(w) **Stock Appreciation Right** means a right granted pursuant to Section 7 that entitles the Participant to receive, in cash or Shares or a combination thereof, as determined by the Administrator, value equal to or otherwise based on the excess of (i) the market price of a specified number of Shares at the time of exercise over (ii) the exercise price of the right, as established by the Administrator on the date of grant.

(x) **Subsidiary** means (i) any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company where each of the corporations in the unbroken chain other than the last corporation owns stock possessing at least 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in the chain, (ii) other than with respect to Incentive Stock Options, any limited liability company, limited partnership, general partnership or other entity, the majority of the equity or ownership interests in which are owned, directly or indirectly, by the Company, and (iii) if specifically determined by the Administrator in the context other than with respect to Incentive Stock Options, any entity in which the Company has a significant ownership interest or that is directly or indirectly controlled by the Company.

(y) **Substitute Awards** means Awards granted or Shares issued by the Company in assumption of, or in substitution or exchange for, awards previously granted, or the right or obligation to make future awards, by a person or entity acquired by the Company or any Subsidiary or with which the Company or any Subsidiary merges or combines.

(z) **Termination of Employment** means ceasing to serve as a full-time employee of the Company and its Subsidiaries or, with respect to a Nonemployee Director or other Service Provider, ceasing to serve as such for the Company, except that with respect to all or any Awards held by a Participant (i) the Administrator may determine, subject to Section 6(d), that an approved leave of absence or approved employment on a less than full-time basis is not considered a Termination of Employment, (ii) the Administrator may determine that a transition of employment to service with a partnership, joint venture or corporation not meeting the requirements of a Subsidiary in which the Company or a Subsidiary is a party is not considered a Termination of Employment, (iii) service as a member of the Board shall constitute continued employment with respect to Awards granted to a Participant while he or she served as an employee and (iv) service as an employee of the Company or a Subsidiary shall constitute continued employment with respect to Awards granted to a Participant while he or she served as a member of the Board. The Administrator shall determine whether any corporate transaction, such as a sale or spin-off of a division or subsidiary that employs a Participant, shall be deemed to result in a Termination of Employment with the Company and its Subsidiaries for purposes of any affected Participant's Awards, and the Administrator's decision shall be final and binding. Unless determined otherwise by the Administrator, a Termination of Employment will be interpreted consistent with the definition of a separation from service under the Code Section 409A Regulations.

### **3. Eligibility**

Any person who is a current or prospective officer or employee (including, without limitation, any director who is also an employee, in his or her capacity as such) of the Company or of any Subsidiary shall be eligible for selection by the Administrator for the grant of Awards hereunder. To the extent provided by Section 5(e), any Nonemployee Director shall be eligible for the grant of Awards hereunder as determined by the Administrator. In addition, to the extent provided by Section 5(f), any Service Provider shall be eligible for selection by the Administrator for the grant of Awards hereunder. Options intending to qualify as Incentive Stock Options may

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only be granted to employees of the Company or any Subsidiary within the meaning of Section 424(f) the Code, as selected by the Administrator.

**4. Effective Date and Termination of Plan**

This Plan was originally adopted by the Board on November 17, 2005, and became effective as of January 26, 2006 (the **Original Effective Date**) upon approval by the Company's stockholders. The restated Plan was adopted by the Compensation Committee of the Board and became effective as of December 11, 2014 (the **Restated Plan Effective Date**), subject to the approval by the Company's stockholders. The Plan shall remain available for the grant of Awards until the tenth (10th) anniversary of the Restated Plan Effective Date. Notwithstanding the foregoing, the Plan may be terminated at such earlier time as the Board or the Compensation Committee of the Board may determine. Termination of the Plan will not affect the rights and obligations of the Participants and the Company arising under Awards theretofore granted and then in effect.

**5. Shares Subject to the Plan and to Awards**

(a) *Aggregate Limits.* The aggregate number of Shares issuable under the Plan pursuant to Awards granted after December 1, 2014 shall be equal to 28,542,060, plus (i) any Shares that were authorized for issuance under the Prior Plan that, as of January 26, 2006, remained available for issuance under the Prior Plan (not including any Shares that were subject to, as of January 26, 2006, outstanding awards under the Prior Plan or any Shares that prior to January 26, 2006 were issued pursuant to awards granted under the Prior Plan) and (ii) any shares of Common Stock subject to outstanding Awards under the Prior Plan as of January 26, 2006 or the Plan as of the Restated Plan Effective Date that on or after such date cease for any reason to be subject to such Awards (other than by reason of exercise or settlement of the awards to the extent they are exercised for or settled in nonforfeitable Shares); provided that any Shares granted under Options or Stock Appreciation Rights shall be counted against this limit on a one-for-one basis and any Shares granted as Awards other than Options or Stock Appreciation Rights shall be counted against this limit as 1.5 Shares for every one Share subject to such Award. The aggregate number of Shares available for grant under this Plan and the number of Shares subject to outstanding Awards shall be subject to adjustment as provided in Section 12. The Shares issued pursuant to Awards granted under this Plan may be shares that are authorized and unissued or shares that were reacquired by the Company, including, without limitation, shares purchased in the open market.

(b) *Issuance of Shares.* For purposes of Section 5(a), the aggregate number of Shares issued under this Plan at any time shall equal only the number of Shares actually issued upon exercise or settlement of an Award. Notwithstanding the foregoing, Shares subject to an Award under the Plan may not again be made available for issuance under the Plan if such Shares are: (i) Shares that were subject to a stock-settled Stock Appreciation Right (or stock appreciation right under the Prior Plan) and were not issued upon the net settlement or net exercise of such Stock Appreciation Right (or stock appreciation right under the Prior Plan), (ii) Shares delivered to or withheld by the Company to pay the exercise price of a Stock Option (or stock option under the Prior Plan), (iii) Shares delivered to or withheld by the Company to pay the withholding taxes related to a Stock Option or a Stock Appreciation Right (or stock option or stock appreciation right under the Prior Plan), or (iv) Shares repurchased on the open market with the proceeds of a Stock Option (or option under the Prior Plan) exercise. Shares subject to Awards that have been canceled, expired, forfeited or otherwise not issued under an Award and Shares subject to Awards settled in cash shall not count as Shares issued under this Plan; provided however, that any Shares that again become available for grant pursuant to this Section 5 shall be added back on a one-for-one basis if such Shares were subject to Awards of Options or Stock Appreciation Rights (or stock options or stock appreciation rights under the Prior Plan) or added back as one and one-half (1.5) Shares for all Shares granted as Awards other than Options or Stock Appreciation Rights (or awards other than stock options or stock appreciation rights under the Prior Plan).

(c) *Substitute Awards.* Substitute Awards shall not reduce the Shares authorized for issuance under the Plan or authorized for grant to a Participant in any calendar year. In addition, in the event that a person or entity



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acquired by the Company or any Subsidiary, or with which the Company or any Subsidiary merges or combines, has shares available under a pre-existing plan approved by its stockholders and not adopted in contemplation of such acquisition, merger or combination, the shares available for grant pursuant to the terms of such pre-existing plan (as adjusted, to the extent appropriate, using the exchange ratio or other adjustment or valuation ratio or formula used in such acquisition, merger or combination to determine the consideration payable to the holders of common stock of the entities party to such transaction) may be used for Awards under the Plan and, notwithstanding any other provision hereof, shall not reduce the Shares authorized for issuance under the Plan; provided that Awards using such available shares shall not be made after the date awards or grants could have been made under the terms of the pre-existing plan, absent the acquisition, merger or combination, and shall only be made to individuals who were employees, directors or Service Providers of such acquired, merged or combined company before such acquisition, merger or combination.

(d) *Tax Code Limits.* The aggregate number of Shares subject to Awards, denominated in Shares, granted under this Plan during any calendar year to any one Participant shall not exceed 750,000, which number shall be calculated and adjusted pursuant to Section 12 only to the extent that such calculation or adjustment will not affect the status of any Award intended to qualify as performance based compensation under Section 162(m) of the Code but which number shall not count any tandem SARs (as defined in Section 7). The aggregate number of Shares that may be issued pursuant to the exercise of Incentive Stock Options granted under this Plan shall not exceed 28,542,060, which number shall be calculated and adjusted pursuant to Section 12 only to the extent that such calculation or adjustment will not affect the status of any option intended to qualify as an Incentive Stock Option under Section 422 of the Code. The maximum amount payable pursuant to that portion of an Incentive Bonus, denominated in dollars, granted with respect any specified performance period to any Participant under this Plan that is intended to satisfy the requirements for performance based compensation under Section 162(m) of the Code shall not exceed two percent (2%) of the Company's consolidated pre-tax income for such performance period.

(e) *Director Awards.* The aggregate number of Shares subject to Awards granted under this Plan during any calendar year to any one Nonemployee Director shall not exceed 15,000, which limit shall not count any tandem SARs (as defined in Section 7).

(f) *Awards to Service Providers.* The aggregate number of Shares issued under this Plan pursuant to all Awards granted to Service Providers shall not exceed 300,000.

(g) *Effect on Prior Plan.* From and after the Original Effective Date, no further grants or awards were permitted to be made under the Prior Plan. Grants and awards made under the Prior Plan before the Original Effective Date, however, shall continue in effect in accordance with their terms.

**6. Options**

(a) *Option Awards.* Options may be granted at any time and from time to time prior to the termination of the Plan to Participants as determined by the Administrator. No Participant shall have any rights as a stockholder with respect to any Shares subject to Options hereunder until such Shares have been issued. Each Option shall be evidenced by an Award Agreement. Options granted pursuant to the Plan need not be identical but each Option must contain and be subject to the terms and conditions set forth below.

(b) *Price.* The Administrator will establish the exercise price per Share under each Option, which, in no event will be less than the fair market value of the Shares on the date of grant; provided, however, that the exercise price per Share with respect to an Option that is granted in connection with a merger or other acquisition as a substitute or replacement award for options held by optionees of the acquired entity may be less than 100% of the market price of the Shares on the date such Option is granted if such exercise price is based on a formula set forth in the terms of the options held by such optionees or in the terms of the agreement providing for such

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merger or other acquisition. The exercise price of any Option may be paid in Shares, cash or a combination thereof, as determined by the Administrator, including, without limitation, an irrevocable commitment by a broker to pay over such amount from a sale of the Shares issuable under an Option, the delivery of previously owned Shares and withholding of Shares deliverable upon exercise.

(c) *No Repricing.* Other than in connection with a change in the Company's capitalization or other event or transaction described in Section 12, the terms of outstanding Awards may not be amended to (a) reduce the exercise price of outstanding Options or take any other action that is treated as a re-pricing under generally accepted accounting principles ( GAAP ), or (b) at any time when the exercise price of an Option is above the market value of a Share, cancel, exchange, buyout or surrender outstanding Options in exchange for cash, other awards or Options or Stock Appreciation Rights with an exercise price that is less than the exercise price of the original Options, without stockholder approval.

(d) *Provisions Applicable to Options.* The date on which Options become exercisable shall be determined at the sole discretion of the Administrator and set forth in an Award Agreement. Unless provided otherwise in the applicable Award Agreement, to the extent that the Administrator determines that an approved leave of absence or employment on a less than full-time basis is not a Termination of Employment, the vesting period and/or exercisability of an Option shall be adjusted by the Administrator during or to reflect the effects of any period during which the Participant is on an approved leave of absence or is employed on a less than full-time basis.

(e) *Term of Options and Termination of Employment.* The Administrator shall establish the term of each Option, which in no case shall exceed a period of ten (10) years from the date of grant; provided, however, the term of an Option (other than an Incentive Stock Option) shall be automatically extended if, at the time of its scheduled expiration, the Participant holding such Option is prohibited by law or the Company's insider trading policy from exercising the Option, which extension shall expire on the thirtieth (30th) day following the date such prohibition no longer applies. In addition, the Award Agreement evidencing the grant of each Option shall set forth the terms and conditions applicable to such Option upon a Participant's Termination of Employment.

(f) *Incentive Stock Options.* Notwithstanding anything to the contrary in this Section 6, in the case of the grant of an Option intending to qualify as an Incentive Stock Option: (i) if the Participant owns stock possessing more than 10 percent of the combined voting power of all classes of stock of the Company (a **10% Shareholder** ), the exercise price of such Option must be at least 110 percent of the fair market value of the Shares on the date of grant and the Option must expire within a period of not more than five (5) years from the date of grant, and (ii) Termination of Employment will occur when the person to whom an Award was granted ceases to be an employee (as determined in accordance with Section 3401(c) of the Code and the regulations promulgated thereunder) of the Company and its Subsidiaries. Notwithstanding anything in this Section 6 to the contrary, options designated as Incentive Stock Options shall not be eligible for treatment under the Code as Incentive Stock Options (and will be deemed to be Nonqualified Stock Options) to the extent that either (a) the aggregate fair market value of Shares (determined as of the time of grant) with respect to which such Options are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Subsidiary) exceeds \$100,000, taking Options into account in the order in which they were granted, or (b) such Options otherwise remain exercisable but are not exercised within three (3) months of Termination of Employment (or such other period of time provided in Section 422 of the Code).

(g) *No Stockholder Rights.* Participants shall have no voting rights and will have no rights to receive dividends or dividend equivalents in respect of an Option or any Shares subject to an Option until the Participant has become the holder of record of such Shares.

**7. Stock Appreciation Rights**

Stock Appreciation Rights may be granted to Participants from time to time either in tandem with or as a component of other Awards granted under the Plan ( **tandem SARs** ) or not in conjunction with other Awards

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( **freestanding SARs** ) and may, but need not, relate to a specific Option granted under Section 6. The provisions of Stock Appreciation Rights need not be the same with respect to each grant or each recipient. Any Stock Appreciation Right granted in tandem with an Award may be granted at the same time such Award is granted or at any time thereafter before exercise or expiration of such Award. All freestanding SARs shall be granted subject to the same terms and conditions applicable to Options as set forth in Section 6 (including, without limitation, no repricing) and all tandem SARs shall have the same exercise price, vesting, exercisability, forfeiture and termination provisions as the Award to which they relate. Subject to the provisions of Section 6 and the immediately preceding sentence, the Administrator may impose such other conditions or restrictions on any Stock Appreciation Right as it shall deem appropriate. Stock Appreciation Rights may be settled in Shares, cash or a combination thereof, as determined by the Administrator and set forth in the applicable Award Agreement. Other than in connection with a change in the Company's capitalization or other event or transaction described in Section 12, the terms of outstanding Awards may not be amended to (a) reduce the exercise price of outstanding Stock Appreciation Rights or take any other action that is treated as a re-pricing under GAAP, or (b) at any time when the exercise price of an SAR is above the market value of a Share, cancel, exchange, buyout or surrender outstanding Stock Appreciation Rights in exchange for cash, other awards or Options or Stock Appreciation Rights with an exercise price that is less than the exercise price of the original Stock Appreciation Rights, without stockholder approval. Participants shall have no voting rights and will have no rights to receive dividends or dividend equivalents in respect of an Award of Stock Appreciation Rights or any Shares subject to an Award of Stock Appreciation Rights until the Participant has become the holder of record of such Shares.

**8. Restricted Stock and Restricted Stock Units**

(a) *Restricted Stock and Restricted Stock Unit Awards.* Restricted Stock and Restricted Stock Units may be granted at any time and from time to time prior to the termination of the Plan to Participants as determined by the Administrator. Restricted Stock is an award or issuance of Shares the grant, issuance, retention, vesting and/or transferability of which is subject during specified periods of time to such conditions (including, without limitation, continued employment or performance conditions) and terms as the Administrator deems appropriate. Restricted Stock Units are Awards denominated in units of Shares under which the issuance of Shares is subject to such conditions (including, without limitation, continued employment or performance conditions) and terms as the Administrator deems appropriate. Each grant of Restricted Stock and Restricted Stock Units shall be evidenced by an Award Agreement. Unless determined otherwise by the Administrator, each Restricted Stock Unit will be equal to one Share and will entitle a Participant to either the issuance of Shares or payment of an amount of cash determined with reference to the value of Shares. To the extent determined by the Administrator, Restricted Stock and Restricted Stock Units may be satisfied or settled in Shares, cash or a combination thereof. Restricted Stock and Restricted Stock Units granted pursuant to the Plan need not be identical but each grant of Restricted Stock and Restricted Stock Units must contain and be subject to the terms and conditions set forth below.

(b) *Contents of Agreement.* Each Award Agreement shall contain provisions regarding (i) the number of Shares or Restricted Stock Units subject to such Award or a formula for determining such number, (ii) the purchase price of the Shares, if any, and the means of payment, (iii) the performance criteria, if any, and level of achievement versus these criteria that shall determine the number of Shares or Restricted Stock Units granted, issued, retainable and/or vested, (iv) such terms and conditions on the grant, issuance, vesting and/or forfeiture of the Shares or Restricted Stock Units as may be determined from time to time by the Administrator, (v) the term of the performance period, if any, as to which performance will be measured for determining the number of such Shares or Restricted Stock Units, and (vi) restrictions on the transferability of the Shares or Restricted Stock Units. Shares issued under a Restricted Stock Award may be issued in the name of the Participant and held by the Participant or held by the Company, in each case as the Administrator may provide.

(c) *Vesting and Performance Criteria.* The grant, issuance, retention, vesting and/or, subject to Section 10, settlement of shares of Restricted Stock and Restricted Stock Units will occur when and in such installments as the Administrator determines or under criteria the Administrator establishes, which may include Qualifying

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**Performance Criteria.** The grant, issuance, retention, vesting and/or settlement of Shares under any such Award that is based on performance criteria and level of achievement versus such criteria will be subject to a performance period of not less than one (1) year, and the grant, issuance, retention, vesting and/or settlement of Shares under any Restricted Stock or Restricted Stock Unit Award that is based solely upon continued employment and/or the passage of time may not vest or be settled in full over a period of less than three (3) years but may be subject to pro-rata vesting over such period, except that the Administrator may provide for the satisfaction and/or lapse of all conditions under any such Award in the event of the Participant's death, disability, retirement or in connection with a Change in Control of the Company, and the Administrator may provide that any such restriction or limitation will not apply in the case of a Restricted Stock or Restricted Stock Unit Award that is issued in payment or settlement of compensation that has been earned by the Participant or that qualifies as a Substitute Award. Notwithstanding anything in this Plan to the contrary, the performance criteria for any Restricted Stock or Restricted Stock Unit that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code will be a measure based on one or more Qualifying Performance Criteria selected by the Administrator and specified when the Award is granted.

(d) *Discretionary Adjustments and Limits.* Subject to the limits imposed under Section 162(m) of the Code for Awards that are intended to qualify as performance based compensation, notwithstanding the satisfaction of any performance goals, the number of Shares granted, issued, retainable and/or vested under an Award of Restricted Stock or Restricted Stock Units on account of either financial performance or personal performance evaluations may, to the extent specified in the Award Agreement, be reduced, but not increased, by the Administrator on the basis of such further considerations as the Administrator shall determine.

(e) *Voting Rights.* Unless otherwise determined by the Administrator, Participants holding shares of Restricted Stock granted hereunder may exercise full voting rights with respect to those shares during the period of restriction. Participants shall have no voting rights with respect to Shares underlying Restricted Stock Units unless and until such Shares are reflected as issued and outstanding shares on the Company's stock ledger.

(f) *Dividends and Distributions.* Participants in whose name Restricted Stock is granted shall be entitled to receive all dividends and other distributions paid with respect to those Shares, unless determined otherwise by the Administrator. The Administrator will determine whether any such dividends or distributions will be automatically reinvested in additional shares of Restricted Stock and subject to the same restrictions on transferability as the Restricted Stock with respect to which they were distributed or whether such dividends or distributions will be paid in cash. Shares underlying Restricted Stock Units shall be entitled to dividends or dividend equivalents only to the extent provided by the Administrator. Notwithstanding the foregoing, any dividends or distributions on performance-based Restricted Stock or Restricted Stock Units shall be subject to the same performance-based vesting criteria and other restrictions on transferability as the underlying Restricted Stock (or Restricted Stock Units) with respect to which they were paid or distributed.

(g) *Termination of Employment.* The Award Agreement evidencing the grant of an Award of Restricted Stock or Restricted Stock Units shall set forth the terms and conditions applicable to such Award upon a Participant's Termination of Employment.

**9. Incentive Bonuses**

(a) *General.* Each Incentive Bonus Award will confer upon the Participant the opportunity to earn a future payment tied to the level of achievement with respect to one or more performance criteria established for a performance period of not less than one year (if payable in Shares), and not less than one calendar quarter (if payable solely in cash).

(b) *Incentive Bonus Document.* The terms of any Incentive Bonus will be set forth in an Award Agreement. Each Award Agreement evidencing an Incentive Bonus shall contain provisions regarding (i) the target and maximum amount payable to the Participant as an Incentive Bonus, (ii) the performance criteria and level of achievement versus these criteria that shall determine the amount of such payment, (iii) the term of the performance period as to which performance shall be measured for determining the amount of any payment,

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(iv) the timing of any payment earned by virtue of performance, (v) restrictions on the alienation or transfer of the Incentive Bonus prior to actual payment, (vi) forfeiture provisions and (vii) such further terms and conditions, in each case not inconsistent with this Plan as may be determined from time to time by the Administrator.

(c) *Performance Criteria.* The Administrator shall establish the performance criteria and level of achievement versus these criteria that shall determine the target and maximum amount payable under an Incentive Bonus, which criteria may be based on financial performance and/or personal performance evaluations. The Administrator may specify the percentage of the target Incentive Bonus that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code. Notwithstanding anything to the contrary herein, the performance criteria for any portion of an Incentive Bonus that is intended by the Administrator to satisfy the requirements for performance-based compensation under Section 162(m) of the Code shall be a measure based on one or more Qualifying Performance Criteria (as defined in Section 13(b)) selected by the Administrator and specified at the time the Incentive Bonus is granted. The Administrator shall certify the extent to which any Qualifying Performance Criteria has been satisfied, and the amount payable as a result thereof, prior to payment of any Incentive Bonus that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code.

(d) *Timing and Form of Payment.* The Administrator shall determine the timing of payment of any Incentive Bonus. Payment of the amount due under an Incentive Bonus may be made in cash or in Shares, as determined by the Administrator. Subject to Section 10, the Administrator may provide for or, subject to such terms and conditions as the Administrator may specify, may permit a Participant to elect for the payment of any Incentive Bonus to be deferred to a specified date or event.

(e) *Discretionary Adjustments.* Notwithstanding satisfaction of any performance goals, the amount paid under an Incentive Bonus on account of either financial performance or personal performance evaluations may, to the extent specified in the Award Agreement, be reduced, but not increased, by the Administrator on the basis of such further considerations as the Administrator shall determine.

**10. Deferral of Gains**

The Administrator may, in an Award Agreement or otherwise, provide for the deferred delivery of Shares or cash upon settlement, vesting or other events with respect to Restricted Stock or Restricted Stock Units, or in payment or satisfaction of an Incentive Bonus. Notwithstanding anything herein to the contrary, in no event will any deferral of the delivery of Shares or any other payment with respect to any Award be allowed if the Administrator determines that the deferral would result in the imposition of the additional tax under Section 409A(a)(1)(B) of the Code. The Company shall have no liability to a Participant, or any other party, if an Award that is intended to be exempt from, or compliant with, Section 409A of the Code is not so exempt or compliant or for any action taken by the Board.

To the extent any payment under this Plan is considered deferred compensation subject to the restrictions contained in Section 409A of the Code, such payment may not be made to a specified employee (as determined in accordance with a uniform policy adopted by the Company with respect to all arrangements subject to Section 409A of the Code) upon a separation from service (as defined for purposes of Section 409A of the Code) before the date that is six months after the specified employee's separation from service (or, if earlier, the specified employee's death). Any payment that would otherwise be made during this period of delay shall be accumulated and paid on the sixth month plus one day following the specified employee's separation from service (or, if earlier, as soon as administratively practicable after the specified employee's death).

**11. Conditions and Restrictions Upon Securities Subject to Awards**

The Administrator may provide that the Shares issued upon exercise of an Option or Stock Appreciation Right or otherwise subject to or issued under an Award shall be subject to such further agreements, restrictions, conditions or limitations as the Administrator in its discretion may specify prior to the exercise of such Option or

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Stock Appreciation Right or the grant, vesting or settlement of such Award, including, without limitation, conditions on vesting or transferability, forfeiture or repurchase provisions and method of payment for the Shares issued upon exercise, vesting or settlement of such Award (including, without limitation, the actual or constructive surrender of Shares already owned by the Participant) or payment of taxes arising in connection with an Award. Without limiting the foregoing, such restrictions may address the timing and manner of any resales by the Participant or other subsequent transfers by the Participant of any Shares issued under an Award, including, without limitation (i) restrictions under an insider trading policy or pursuant to applicable law, (ii) restrictions designed to delay and/or coordinate the timing and manner of sales by Participant and holders of other Company equity compensation arrangements, (iii) restrictions as to the use of a specified brokerage firm for such resales or other transfers and (iv) provisions requiring Shares to be sold on the open market or to the Company in order to satisfy tax withholding or other obligations.

**12. Adjustment of and Changes in the Stock**

The number and kind of Shares available for issuance under this Plan (including, without limitation, under any Awards then outstanding), and the number and kind of Shares subject to the individual limits set forth in Section 5 of this Plan, shall be equitably adjusted by the Administrator as it determines appropriate to reflect any reorganization, reclassification, combination or exchange of shares, repurchase of shares, stock split, reverse stock split, spin-off, dividend or other distribution of securities, property or cash (other than regular, quarterly cash dividends), or any other event or transaction that affects the number or kind of Shares of the Company outstanding. Such adjustment may be designed to comply with Section 425 of the Code or, except as otherwise expressly provided in Section 5(d) of this Plan, may be designed to treat the Shares available under the Plan and subject to Awards as if they were all outstanding on the record date for such event or transaction or to increase the number of such Shares to reflect a deemed reinvestment in Shares of the amount distributed to the Company's securityholders. The terms of any outstanding Award shall also be equitably adjusted by the Administrator as to price, number or kind of Shares subject to such Award, vesting, and other terms to reflect the foregoing events, which adjustments need not be uniform as between different Awards or different types of Awards.

In the event there shall be any other change in the number or kind of outstanding Shares, or any stock or other securities into which such Shares shall have been changed, or for which it shall have been exchanged, by reason of a Change in Control, other merger, consolidation or otherwise, then the Administrator shall, in its sole discretion, determine the appropriate and equitable adjustment, if any, to be effected. Without limiting the generality of the foregoing, in the event of any such change described in this paragraph, the Administrator may, in its sole discretion, (i) provide for the assumption or substitution of, or adjustment to, each outstanding Award; (ii) accelerate the vesting of and terminate any restrictions on outstanding Awards; (iii) provide for cancellation of accelerated Awards that are not exercised within a time prescribed by the Administrator; or (iv) provide for the cancellation of any outstanding Awards in exchange for a cash payment to the holders thereof.

No right to purchase fractional shares shall result from any adjustment in Awards pursuant to this Section 12. In case of any such adjustment, the Shares subject to the Award shall be rounded down to the nearest whole share. The Company shall notify Participants holding Awards subject to any adjustments pursuant to this Section 12 of such adjustment, but (whether or not notice is given) such adjustment shall be effective and binding for all purposes of the Plan.

**13. Qualifying Performance-Based Compensation**

(a) *General.* The Administrator may establish performance criteria and level of achievement versus such criteria that shall determine the number of Shares to be granted, retained, vested, issued or issuable under or in settlement of or the amount payable pursuant to an Award, which criteria may be based on Qualifying Performance Criteria or other standards of financial performance and/or personal performance evaluations. In addition, the Administrator may specify that an Award or a portion of an Award is intended to satisfy the

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requirements for performance-based compensation under Section 162(m) of the Code, provided that the performance criteria for such Award or portion of an Award that is intended by the Administrator to satisfy the requirements for performance-based compensation under Section 162(m) of the Code shall be a measure based on one or more Qualifying Performance Criteria selected by the Administrator and specified at the time the Award is granted (or within the time period required by Section 162(m) of the Code). The Administrator shall certify the extent to which any Qualifying Performance Criteria has been satisfied, and the amount payable as a result thereof, prior to payment, settlement or vesting of any Award that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code. Notwithstanding satisfaction of any performance goals, the number of Shares issued under or the amount paid under an Award that is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code may, to the extent specified in the Award Agreement, be reduced (but not increased) by the Administrator on the basis of such further considerations as the Administrator in its sole discretion shall determine.

(b) *Qualifying Performance Criteria.* For purposes of this Plan, the term Qualifying Performance Criteria shall mean any one or more of the following performance criteria, either individually, alternatively or in any combination, applied to either the Company as a whole or to a business unit or Subsidiary, either individually, alternatively or in any combination, and measured either quarterly, annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years' results or to a designated comparison group, in each case as specified by the Administrator: (i) cash flow (before or after dividends), (ii) earnings per share (including, without limitation, earnings before interest, taxes, depreciation and amortization), (iii) stock price, (iv) return on equity, (v) stockholder return or total stockholder return, (vi) return on capital (including, without limitation, return on total capital or return on invested capital), (vii) return on investment, (viii) return on assets or net assets, (ix) market capitalization, (x) economic value added, (xi) debt leverage (debt to capital), (xii) revenue, (xiii) sales or net sales, (xiv) backlog, (xv) income, pre-tax income or net income, (xvi) operating income or pre-tax profit, (xvii) operating profit, net operating profit or economic profit, (xviii) gross margin, operating margin or profit margin, (xix) return on operating revenue or return on operating assets, (xx) cash from operations, (xxi) operating ratio, (xxii) operating revenue, (xxiii) market share improvement, (xxiv) general and administrative expenses, (xxv) gross profit or gross profit percentage, (xxvi) income or pre-tax income percentage, (xxvii) selling, general and administrative expense improvement or containment, (xxviii) land, lot or inventory improvement or (xxix) customer service. To the extent consistent with Section 162(m) of the Code, the Administrator may appropriately adjust any evaluation of performance under a Qualifying Performance Criteria to exclude any of the following events that occurs during a performance period: (i) asset write-downs or asset impairments, (ii) litigation, claims, judgments or settlements, (iii) the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results, (iv) accruals for reorganization and restructuring programs or accruals for any amounts for payment under this Plan or any other compensation arrangement maintained by the Company and (v) any extraordinary, unusual, non-recurring or non-comparable items (A) as determined in accordance with generally accepted accounting principles, (B) as identified in the Company's financial statements or notes to the financial statements, (C) as described in management's discussion and analysis of financial condition and results of operations appearing in the Company's Annual Report to stockholders for the applicable year, or (D) publicly announced by the Company in a press release or conference call relating to the Company's results of operations or financial condition for a completed quarterly or annual fiscal period.

**14. Transferability**

Unless the Administrator specifies otherwise and to the extent permitted under the General Instructions to Form S-8 under the Securities Act of 1933, as amended, an Award may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated by a Participant other than by will or the laws of descent and distribution, and each Option or Stock Appreciation Right shall be exercisable only by the Participant during his or her lifetime, and thereafter by the legal representative of the Participant's estate or the individual to whom such Award was transferred by the Participant's will or the laws of descent and distribution.

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**Table of Contents****15. Compliance with Laws and Regulations**

This Plan, the grant, issuance, vesting, exercise and settlement of Awards thereunder, and the obligation of the Company to sell, issue or deliver Shares under such Awards, shall be subject to all applicable foreign, federal, state and local laws, rules and regulations, stock exchange rules and regulations, and to such approvals by any governmental or regulatory agency as may be required. The Company shall not be required to register in a Participant's name or deliver any Shares prior to the completion of any registration or qualification of such shares under any foreign, federal, state or local law or any ruling or regulation of any government body which the Administrator shall determine to be necessary or advisable. To the extent the Company is unable to or the Administrator deems it infeasible to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, the Company and its Subsidiaries shall be relieved of any liability with respect to the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained. No Option shall be exercisable and no Shares shall be issued and/or transferable under any other Award unless a registration statement with respect to the Shares underlying such Option is effective and current or the Company has determined that such registration is unnecessary.

In the event an Award is granted to or held by a Participant who is employed or providing services outside the United States, the Administrator may, in its sole discretion, modify the provisions of the Plan or of such Award as they pertain to such individual to comply with applicable foreign law or to recognize differences in local law, currency or tax policy. The Administrator may also impose conditions on the grant, issuance, exercise, vesting, settlement or retention of Awards in order to comply with such foreign law and/or to minimize the Company's obligations with respect to tax equalization for Participants employed outside their home country.

**16. Withholding**

To the extent required by applicable federal, state, local or foreign law, a Participant shall be required to satisfy, in a manner satisfactory to the Company, any withholding tax obligations that arise by reason of an Option exercise, disposition of Shares issued under an Incentive Stock Option, the vesting of or settlement of an Award, an election pursuant to Section 83(b) of the Code or otherwise with respect to an Award. To the extent a Participant makes an election under Section 83(b) of the Code, within ten days of filing such election with the Internal Revenue Service, the Participant must notify the Company in writing of such election. The Company and its Subsidiaries shall not be required to issue Shares, make any payment or to recognize the transfer or disposition of Shares until such obligations are satisfied. The Administrator may provide for or permit these obligations to be satisfied through the mandatory or elective sale of Shares and/or by having the Company withhold a portion of the Shares that otherwise would be issued to him or her upon exercise of the Option or the vesting or settlement of an Award, or by tendering Shares previously acquired.

**17. Administration of the Plan**

(a) *Administrator of the Plan.* The Plan shall be administered by the Administrator who shall be the Compensation Committee of the Board or, in the absence of a Compensation Committee, the Board itself; provided, however, that with respect to Awards to Nonemployee Directors, the Administrator shall be the full Board. Any power of the Administrator may also be exercised by the Board, except to the extent that the grant or exercise of such authority would cause any Award or transaction to become subject to (or lose an exemption under) the short-swing profit recovery provisions of Section 16 of the Exchange Act or cause an Award designated as a Performance Award not to qualify for treatment as performance-based compensation under Section 162(m) of the Code. To the extent that any permitted action taken by the Board conflicts with action taken by the Administrator, the Board action shall control. The Administrator may by resolution authorize one or more officers of the Company to perform any or all things that the Administrator is authorized and empowered to do or perform under the Plan, and for all purposes under this Plan, such officer or officers shall be treated as the Administrator; provided, however, that the resolution so authorizing such officer or officers shall specify the total



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number of Awards (if any) such officer or officers may award pursuant to such delegated authority. No such officer shall designate himself or herself or any executive officer or director of the Company as a recipient of any Awards granted under authority delegated to such officer. In addition, the Administrator may delegate any or all aspects of the day-to-day administration of the Plan to one or more officers or employees of the Company or any Subsidiary, and/or to one or more agents.

(b) *Powers of Administrator.* Subject to the express provisions of this Plan, the Administrator shall be authorized and empowered to do all things that it determines to be necessary or appropriate in connection with the administration of this Plan, including, without limitation: (i) to prescribe, amend and rescind rules and regulations relating to this Plan and to define terms not otherwise defined herein; (ii) to determine which persons are Participants, to which of such Participants, if any, Awards shall be granted hereunder and the timing of any such Awards; (iii) to grant Awards to Participants and determine the terms and conditions thereof, including, without limitation, the number of Shares subject to Awards and the exercise or purchase price of such Shares and the circumstances under which Awards become exercisable or vested or are forfeited or expire, which terms may but need not be conditioned upon the passage of time, continued employment, the satisfaction of performance criteria, the occurrence of certain events (including, without limitation, events which the Board or the Administrator determine constitute a change of control), or other factors; (iv) to establish and verify the extent of satisfaction of any performance goals or other conditions applicable to the grant, issuance, exercisability, vesting and/or ability to retain any Award; (v) to prescribe and amend the terms of the agreements or other documents evidencing Awards made under this Plan (which need not be identical) and the terms of or form of any document or notice required to be delivered to the Company by Participants under this Plan; (vi) to determine whether, and the extent to which, adjustments are required pursuant to Section 12; (vii) to interpret and construe this Plan, any rules and regulations under this Plan and the terms and conditions of any Award granted hereunder, and to make exceptions to any such provisions if the Administrator, in good faith, determines that it is necessary to do so in light of the circumstances and for the benefit of the Company; (viii) to approve corrections in the documentation or administration of any Award; (ix) subject to any limitations otherwise set forth in Section 18, waive, settle or adjust the terms of any Award so as to avoid unanticipated consequences, to implement the intent of the Award, or address unanticipated events (including, but not limited to, any temporary closure of an applicable stock exchange, disruption of communications or natural catastrophe); and (x) to make all other determinations deemed necessary or advisable for the administration of this Plan. The Administrator may, in its sole and absolute discretion, without amendment to the Plan, waive or amend the operation of Plan provisions respecting exercise after Termination of Employment or service to the Company or an affiliate and, except as otherwise provided herein, adjust any of the terms of any Award. Notwithstanding anything in the Plan to the contrary, other than in connection with a change in the Company's capitalization or other event or transaction described in Section 12, the terms of outstanding Awards may not be amended to (a) reduce the exercise price of outstanding Options or Stock Appreciation Rights or take any other action that is treated as a re-pricing under GAAP, or (b) at any time when the exercise price of an Option or SAR is greater than the market value of a Share, cancel, exchange, buyout or surrender outstanding Options or Stock Appreciation Rights in exchange for cash, other awards or Options or Stock Appreciation Rights with an exercise price that is less than the exercise price of the original Options or Stock Appreciation Rights, without stockholder approval.

(c) *Determinations by the Administrator.* All decisions, determinations and interpretations by the Administrator regarding the Plan, any rules and regulations under the Plan and the terms and conditions of or operation of any Award granted hereunder, shall be final and binding on all Participants, beneficiaries, heirs, assigns or other persons holding or claiming rights under the Plan or any Award. The Administrator shall consider such factors as it deems relevant, in its sole and absolute discretion, to making such decisions, determinations and interpretations including, without limitation, the recommendations or advice of any officer or other employee of the Company and such attorneys, consultants and accountants as it may select.

(d) *Subsidiary Awards.* In the case of a grant of an Award to any Participant employed by a Subsidiary, such grant may, if the Administrator so directs, be implemented by the Company issuing any subject Shares to the Subsidiary, for such lawful consideration as the Administrator may determine, upon the condition or understanding that the Subsidiary will transfer the Shares to the Participant in accordance with the terms of the

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Award specified by the Administrator pursuant to the provisions of the Plan. Notwithstanding any other provision hereof, such Award may be issued by and in the name of the Subsidiary and shall be deemed granted on such date as the Administrator shall determine.

**18. Amendment of the Plan or Awards**

The Board or the Compensation Committee of the Board may amend, alter or discontinue this Plan, and the Administrator may amend or alter any agreement or other document evidencing an Award made under this Plan but, except as provided pursuant to the provisions of Section 12, no such amendment shall, without the approval of the stockholders of the Company:

- (a) increase the maximum number of Shares for which Awards may be granted under this Plan;
- (b) whether before or after the date of grant, reduce the price at which Options or Stock Appreciation Rights may be exercised below the price provided for in Section 6(b) or Section 7;
- (c) other than in connection with a change in the Company's capitalization or other event or transaction described in Section 12, amend the terms of outstanding Awards to (a) reduce the exercise price of outstanding Options or Stock Appreciation Rights or take any other action that is treated as a re-pricing under GAAP, or (b) at any time when the exercise price of an Option or SAR is greater than the market value of a Share, cancel, exchange, buyout or surrender outstanding Options or Stock Appreciation Rights in exchange for cash, other awards or Options or Stock Appreciation Rights with an exercise price that is less than the exercise price of the original Options or Stock Appreciation Rights;
- (d) extend the term of this Plan;
- (e) change the class of persons eligible to be Participants;
- (f) otherwise amend the Plan in any manner requiring stockholder approval by law or under the New York Stock Exchange listing requirements; or
- (g) increase the individual maximum limits in Sections 5(d) and (e).

No amendment or alteration to the Plan or an Award or Award Agreement shall be made which would impair the rights of the holder of an Award, without such holder's consent, provided that no such consent shall be required if (i) the Administrator determines in its sole discretion and prior to the date of any change of control (as defined in the applicable Award Agreement) that such amendment or alteration either is required or advisable in order for the Company, the Plan or the Award to satisfy any law or regulation or stock exchange listing requirement or to meet the requirements of or avoid adverse financial accounting consequences under any accounting standard, or (ii) the Administrator determines in its sole discretion that such amendment or alteration is not reasonably likely to significantly diminish the benefits provided under the Award, or that any such diminution has been adequately compensated.

**19. No Liability of Company**

The Company and any Subsidiary or affiliate which is in existence or hereafter comes into existence shall not be liable to a Participant or any other person as to: (i) the non-issuance or sale of Shares as to which the Company has been unable to obtain from any regulatory body having jurisdiction the authority deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder; and (ii) any tax consequence expected, but not realized, by any Participant or other person due to the receipt, exercise or settlement of any Award granted hereunder.

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**20. Non-Exclusivity of Plan**

Neither the adoption of this Plan by the Board nor the submission of this Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board or the Administrator to adopt such other incentive arrangements as either may deem desirable, including, without limitation, the granting of cash or equity-based compensation awards otherwise than under this Plan or an arrangement that is or is not intended to qualify under Code Section 162(m), and such arrangements may be either generally applicable or applicable only in specific cases.

**21. Governing Law**

This Plan and any agreements or other documents hereunder shall be interpreted and construed in accordance with the laws of the Delaware and applicable federal law. Any reference in this Plan or in the agreement or other document evidencing any Awards to a provision of law or to a rule or regulation shall be deemed to include any successor law, rule or regulation of similar effect or applicability.

**22. No Right to Employment, Reelection or Continued Service**

Nothing in this Plan or an Award Agreement shall interfere with or limit in any way the right of the Company, its Subsidiaries and/or its affiliates to terminate any Participant's employment, service on the Board or service for the Company at any time or for any reason not prohibited by law, nor shall this Plan or an Award itself confer upon any Participant any right to continue his or her employment or service for any specified period of time. Neither an Award nor any benefits arising under this Plan shall constitute an employment contract with the Company, any Subsidiary and/or its affiliates. Subject to Sections 4 and 18, this Plan and the benefits hereunder may be terminated at any time in the sole and exclusive discretion of the Board without giving rise to any liability on the part of the Company, its Subsidiaries and/or its affiliates.

**23. Unfunded Plan**

The Plan is intended to be an unfunded plan. Participants are and shall at all times be general creditors of the Company with respect to their Awards. If the Administrator or the Company chooses to set aside funds in a trust or otherwise for the payment of Awards under the Plan, such funds shall at all times be subject to the claims of the creditors of the Company in the event of its bankruptcy or insolvency.

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301 Commerce Street

Suite 500

Fort Worth, Texas 76102

(817) 390-8200

[www.drhorton.com](http://www.drhorton.com)

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***AMERICAN STOCK TRANSFER & TRUST  
COMPANY***

***6201 15TH AVENUE***

***BROOKLYN, NY 11219***

**VOTE BY INTERNET - [www.proxyvote.com](http://www.proxyvote.com)**

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

**ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS**

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

**VOTE BY PHONE - 1-800-690-6903**

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

**VOTE BY MAIL**

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

M80195-P57051

KEEP THIS PORTION FOR YOUR RECORDS  
DETACH AND RETURN THIS PORTION ONLY

**THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.**

**D.R. HORTON, INC.**

**Vote on Directors**

**The Board of Directors recommends a vote FOR each  
Nominee for Director.**

1. Proposal One:  
Election of  
directors.

<b>Nominees:</b>	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b><u>Vote on Other Proposals</u></b>	<b>For</b>	<b>Against</b>	<b>Abstain</b>	
1a. Donald R. Horton	..	..	..	<b>The Board of Directors recommends a vote <u>FOR</u> Proposal Two, Proposal Three and Proposal Four as proposed below.</b>				
1b. Barbara K. Allen	..	..	..		2. Proposal Two: Advisory vote to approve executive compensation.	..	..	..
1c. Brad S. Anderson	..	..	..		3. Proposal Three: To approve the 2006 Stock Incentive Plan as amended and restated.	..	..	..
1d. Michael R. Buchanan	..	..	..		4. Proposal Four: Ratify the appointment of PricewaterhouseCoopers LLP as our independent	..	..	..
1e. Michael W. Hewatt	..	..	..					

registered public  
accounting firm.

**PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY,  
USING THE ENCLOSED ENVELOPE.**

**NOTE:** Please sign exactly as name(s) appear(s) herein. When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee, or guardian, please give full titles as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by an authorized person.

Signature [PLEASE SIGN WITHIN BOX]

Signature (Joint Owners) \_\_\_\_\_  
Date \_\_\_\_\_

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**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting:**

The Notice and Proxy Statement, Telephone/Internet insert (Company supplied) and Annual Report on Form 10-K are available at [www.proxyvote.com](http://www.proxyvote.com).

M80196-P57051

**D.R. HORTON, INC. 2015 PROXY**

**PROXY**

**D.R. HORTON, INC.**

**D.R. Horton Tower, 301 Commerce Street, Suite 500, Fort Worth, Texas 76102**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned hereby nominates, constitutes and appoints Donald R. Horton and David V. Auld, and each of them, attorneys, agents and proxies of the undersigned, with full power of substitution to each and hereby authorizes them to represent and to vote, as designated on the reverse side of this card, all shares of Common Stock of D.R. Horton, Inc. (*the Company*) held of record by the undersigned at the close of business on December 1, 2014, at the 2015 Annual Meeting of Stockholders to be held on January 22, 2015, or any adjournment thereof.

The Board of Directors recommends a vote **FOR** Proposals One, Two, Three and Four. This proxy when properly executed will be voted in the manner directed herein by the undersigned stockholder. **If no direction is made, this proxy will be voted as recommended by the Board of Directors in this paragraph.** In addition, if any other matter should be properly brought before the meeting, the persons named as proxies will vote on such matters in accordance with their best judgment.

The undersigned hereby ratifies and confirms all that said attorneys and proxies, or any of them, or their substitutes, shall lawfully do or cause to be done by virtue hereof and hereby revokes any and all proxies



heretofore given by the undersigned to vote at said meeting. The undersigned acknowledges receipt of the notice of said annual meeting and the proxy statement accompanying said notice.

**PLEASE SIGN AND DATE ON THE REVERSE SIDE.**