

LENNAR CORP
October 2, 2019
11:00 am EST

Coordinator: Welcome to Lennar's Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. After the presentation, we will conduct a question-and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time. I will now turn the call over to David Collins for the reading of the forward-looking statement.

David Collins: Thank you and good morning everyone.

Today's conference call may include forward-looking statements, including statements regarding Lennar's business, financial condition, results of operations, cash flows, strategies and prospects. Forward-looking statements represent only Lennar's estimates on the date of this conference call and are not intended to give any assurance as to actual future results. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties.

Many factors could affect future results and may cause Lennar's actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include those described in this morning's press release and our SEC filings, including those under the caption "Risk Factors" contained in Lennar's Annual Report on Form 10-K, most recently filed with the SEC.

Please note that Lennar assumes no obligation to update any forward-looking statements.

Coordinator: I would like to introduce your host, Mr. Stuart Miller, Executive Chairman. Sir, you may begin.

Stuart Miller: Great. Good morning and thank you. This morning I'm here with Rick Beckwitt, our Chief Executive Officer; Jon Jaffee, our President; Diane Bessette, Chief Financial Officer; and David Collins who you just heard from. We're out in California today with our board. We have our Board Meeting tomorrow but we're touring our Board on some of our properties out in California, showing them what makes us the company that we are.

I'm going to start today with a brief overview. Rick and Jon are going to give some additional operational remarks and Diane will deliver further detail on our third quarter numbers, as well as some additional guidance for the remainder of this year. As always, when we get to Q&A, we'd like to ask that you limit your questions to just one question and one follow-up so that we can accommodate as many participants as possible.

So let me go ahead and begin by saying that we're very pleased to report a very strong third quarter performance that reflects both the continued recovery in the housing market as well as continued focus on leveraging our size and scale and delivering greater cash flow and higher returns.

Our results reflect the fact that the housing market continued to strengthen throughout the third quarter, confirming and continuing the trend that we reported in our earnings call last quarter. The market for new homes has been improving from last year's pause as lower interest rates have stimulated

demand and improved affordability while the overall fundamentals of the economy have remained strong.

We clearly saw traffic and sales continue to strengthen in the third quarter as a combination of lower interest rates, together with slower price appreciation, have positively impacted affordability. And that together with low unemployment, wage growth, consumer confidence and economic growth, drove the consumer to return to a more affordable housing market.

Current market conditions are strong and they've been continuing to improve as the production deficit driven short supply, lower interest rates, and attractive pricing have motivated consumers.

In the third quarter, we achieved strong net earnings of over \$513 million or \$1.59 per share. This result derived mostly from solid operating results from both Homebuilding and Financial Services. In Homebuilding, stronger sales drove and are driving stronger than expected deliveries at stabilized margin levels of 20.4%, the high end of our guidance as incentives have moderated. While deliveries jumped 7% over last year and new orders improved 9% over last year, our size and scale in most of the best markets in the country enabled us to offset the impact of rising land cost with production cost savings and leverage - and overhead leverage, which has driven our SG&A to an all-time third quarter low of 8.3%. And we're confident that these trends are going to continue into the fourth quarter.

Our Financial Services performance also contributed to our earnings beat. And I'd want to focus on this for a couple of minutes as this performance is a proxy for many of the important initiatives driving our company today.

At the beginning of the quarter, we expected the contribution from this segment to be approximately \$54 million. By the end of the current quarter, our Financial Services segment generated a record quarterly profit of \$78.8 million or an improvement of about 45% from our expectations.

It's noteworthy that having sold our retail mortgage component, our retail title component and our retail home insurance agency, we no longer drive additional volume from spikes in the mortgage refi business that has been booming as rates have gone down. We're only producing from our core business. While some of this beat derives from market conditions, much of the performance story from this segment is about shedding non-core assets which enables our management team to focus on the core homebuilding-oriented business and implement new technologies to streamline the remaining business process, all while improving our customers' experience.

This core focus drove significant operational improvements versus the prior year with fewer assets deployed as follows: first, we increased the company's combined mortgage capture rate from 71% to 77%, having integrated the CalAtlantic business which had much lower capture rates than where Lennar historically operated; second, and perhaps most importantly, we've reduced the cost to originate a loan by 22% from \$7700 per loan to approximately \$6000 per loan, and this is a continuation of the operational improvements which have now driven the origination costs down 33% from \$9000 per loan in 2017; and then third, we've reduced the total Financial Services associate headcount by over 50% from approximately 3700 associates with the announcement of CalAtlantic to now below 1600 associates.

The technology initiatives implemented include robotic processes to automate repetitive detail-oriented tasks that eliminate human error and manual intervention. These initiatives are helping our journey to reduce paper flow,

streamline the closing process and drive a friendlier customer experience. Technology, together with management focus, has enabled efficiency, a better customer experience and a much better bottom line.

Our management team has been focused on incorporating new technologies on our old operating chassis to both drive down cost and to create significantly better customer experience in mortgage with our Blend partnership, in title and escrow services with our States Title partnership, and home insurance with our Hippo insurance partnership. And although ultimately, we will improve our entire end-to-end process to get to a one-tap closing, we're really starting to see the fruits of our focus and investment at the bottom line right now. And these improvements specifically and these types of improvements generally are sustainable and will continue to drive bottom-line improvement in our Financial Services segment and across our company in the future.

Moving on, while strong operating results drove the bottom line, our overall focus on inventory, land spend and shedding non-core assets has driven a strong and improving cash flow picture as well. First, we are reducing our overall inventory levels as we have had a relentless focus on our pivot to land-lighter strategy. From the timing of land purchases to the duration of the land that we buy to the percentage of option versus owned land, we are migrating towards a significantly smaller land inventory, driving our business forward.

Second, we're also driving our asset base lower as we continue to focus on monetizing non-core assets and migrating to a core pure-play homebuilding and financial services platform. As noted, we have shed various non-core Financial Services assets this year. We continue to divest and monetize various remnant Rialto assets and we're working on finding proper

positioning for other ancillary businesses as well. And the latter will happen as quickly as is practical.

With that said, strong operating results, together with our focus on overall inventory reduction, has increased our expected cash flow for this year to \$1.5 billion and projected annual cash flow expectations for 2020 are continuing to head toward the \$2-billion mark. Our strong cash flow and strong cash position enabled us to repay \$500 million of debt at the beginning of the quarter while also opportunistically repurchasing another 6 million shares of stock at an average price of about \$48.50 a share through the quarter. And we will pay off another \$600 million of debt from cash flow right at year-end.

At quarter-end, we had a debt to total cap ratio of approximately 37%, which is a 300-basis point improvement over last year. And while we're not giving specific guidance for 2020 at this time, we're very optimistic about the prospects for next year.

Accordingly, we expect to generate strong cash flow for the remainder of 2019 and expect to continue to use excess cash flow to both pay down debt, while we continue to opportunistically repurchase stock. We expect to see our margins improve steadily throughout the remainder of the year as prices remain stable and incentives continue to subside and ensure that we achieve our 2019 closing target of now approximately 51,000 homes. We are confident that we'll achieve this target, which frankly would have been higher except for the hurricane activity that slowed production at the end of the quarter.

Before I turn over to Rick, Jon and Diane, let me just say that we remain encouraged by both Lennar's position and market conditions for the remainder of the year. Our size and scale in each of our strategic market continues to

facilitate the management of cost and the production in a land and labor-constrained market. Our focus on technology is driving efficiency that is reflected in our consistent improvement in SG&A and our bottom line.

Our strong cash flow and bottom-line profitability are continuing to enable us to reduce debt and return capital to shareholders. Our strong balance sheet continues to improve and position us for the future. And our strategy of shedding non-core assets continues to drive an intensified focus on our core Homebuilding and Financial Services businesses. As the homebuilding market continues to improve in the wake of the recent pause, we're optimistic about our ability to deliver strong and consistent performance for the remainder of 2019 and into 2020.

With that, let me turn over to the rest of the team. Rick?

Rick Beckwitt: Thanks, Stuart. We had a strong quarter, driven by a solid execution of our operating strategy. Homebuilding revenues for the third quarter totaled \$5.4 billion, representing a 3% increase from 2018. This was driven by a 7% increase in deliveries to 13,522 homes and a 5% decrease in average sales price. Deliveries for the quarter exceeded the high-end of our guidance as we were able to accelerate some fourth quarter closings into the third quarter as buyers took advantage of lower mortgage rates.

Our gross margin for the quarter totaled 20.4%, which was just shy of the top side of our prior guidance and up 30 basis points sequentially from the second quarter. This sequential improvement benefited from direct cost savings and was slightly impacted by an increase in the number of closings coming from lower margin third-party option contracts versus land we've developed. This is in line with our land-lighter strategy that is focused on maximizing cash flow and internal rates of return. I will discuss this in greater detail on a bit.

Our SG&A in the quarter was 8.3%. This marks an all-time third quarter low and highlights the power of our increased local market scale and operating leverage. Homebuilding operating earnings totaled \$659 million, up 8% from the prior year. And net earnings for the quarter totaled \$513 million, up 13% from 2018.

New orders for the quarter increased 9% to 13,369 homes, exceeding the high-end of our Q3 guidance. New orders increased in each of our Homebuilding segments with August being the strongest month in the period. From a dollar value perspective, new orders totaled \$5.2 billion, which was up 3% from the prior year. Our average new order sales price declined 5% year-over-year and 2% sequentially, reflecting our continued focus on the strong entry level market. The entry level market now accounts for about 40% of our business. And this will continue to increase as more first-time buyer communities come online and increase our overall community count in 2020.

During our third quarter, we saw increased demand which benefited from lower mortgage rates and increased homebuyer sentiment. Our sales pace per community increased 10% year-over-year. We continue to experience solid traffic on both our Web site and at our Welcome Home Centers and are optimistic that sales will continue to be strong in Q4. We ended the third quarter with a sales backlog of 18,908 homes with a dollar value of \$7.6 billion. This backlog, combined with our current housing inventory, puts us in a great position to close about 51,000 homes in fiscal 2019.

As we look forward to 2020, we are laser-focused on improving our returns on capital and generating significant cash flow. With this in mind, increasing our percentage of option homesites and reducing the amount of owned home sites are top priorities. At the beginning of this year, we set a two-year goal of having 40% of our homesites controlled via options in similar arrangements.

We made great strides on this front in the third quarter as our percentage improved from 25% to 30%.

This increase reflects the strength of our relationship with local developers and their desire to work with us to increase our option position given our size and scale in our markets. We expect to continue to expand on our existing relationships and enter new regional and national land platforms over the next 12 months. Based on this, we are now increasing our goal of controlled homesites to between 40% to 50% of our land needs.

During the third quarter, we also made progress reducing our years owned supply of homesites from 4.5 years to 4.4 years and continue to target a goal of three years. As we reach these two goals, it will enable us to reduce our on-balance sheet land spend and purchase homesites on a takedown basis much closer to the start of the home. This will generate additional cash flow and drive meaningfully greater returns.

Consistent with our land-light strategy and focus on increasing returns, we are continuing to develop a program to address the single-family rental market. There is no question that there is a shortage of affordable and workforce housing and new single-family rental communities can help solve this problem. Given this shortage, there is intense investor interest in new single-family rental communities where the owner can leverage the overhead costs of managing the rentals because they're all the same community with identical features from home to home and Lennar is uniquely positioned to capitalize on this opportunity.

Last quarter, we daylighted our single-family rental program where our homebuilding operation is building and selling homes in bulk in a community on land owned by a third party with no lease-up risk to Lennar. We love this

expansion of our core business as it allows us to leverage our homebuilding machine and existing overhead, and it will generate high returns and profits, all with no accompanying land or lease-up risk.

This is a perfect expansion of our land-light strategy. And given our strong relationship with landowners and developers and our low cost and speed of construction, we're optimistic that we can increase deliveries in the next couple of years. Additionally, this program provides an interesting and unique hedge to our for-sale business.

Now I'd like to turn it over to Jon.

Jon Jaffe: Thanks, Rick. Today I want to speak about our focus on cost reduction across our platform. First, I'll discuss our significant size and scale that led to Lennar becoming the builder of choice, resulting in reduced direct construction costs and advantageous cycle times.

With respect to direct construction costs, I mentioned on our last earnings call that we looked forward at the next few quarters and saw that directionally our direct construction costs were decreasing. This bore out in our third quarter as we saw our direct costs were down sequentially from Q2 by 99 cents per square foot or 1.6%. From a year-over-year perspective, our direct costs were up just 3%. This represents the lowest rate of year-over-year increase in 11 quarters and compares favorably to a year-over-year rate of 7% just last quarter.

We have visibility into the continuation of this trend over the next few quarters as we review the direct costs for homes delivered in Q3 by the quarterly cohort that the homes were started in. Looking at these sequential cohorts, it's very clear that our direct costs are trending down over each

subsequent quarter and will contribute positively to our gross margins going forward.

Sequentially in Q3, our material costs were down 3.5% from Q2.

Significantly, over 65% of our material cost line items were lower sequentially with the biggest declines coming from lumber, drywall and exterior finishes. As I've previously discussed, lumber represents the largest single cost item at approximately 13% of direct total - total direct cost. Lumber reached its low in December 2018 and has since remained in a range averaging about \$350 per 1000 board feet.

On the labor side of cost, the severity of the labor shortage in the construction industry has not abated. But our labor cost moved up just 1% sequentially in Q3 over Q2. We see across all of our markets that our Builder of Choice focus is playing out to allow Lennar to minimize the impacts of this labor shortage.

Some real-time examples of this is we have national and regional manufacturers struggling with critical labor shortages and supply interruptions. In three separate situations, these suppliers who are strategic partners of Lennar are flying in crews and materials from other regions of the country to complete the work in Lennar communities. These are a few examples demonstrating that our size and scale allow us to get above and beyond responses to rectify issues. This is further evidence of our ability to attract trades to our job sites away from other builders, enabling Lennar to have significant cycle time advantages. Size and scale, combined with even flow production in our Everything's Included platform provide a consistent, predictable volume for our trades.

Let me now turn to SG&A for a moment. Given our significant size and scale, we're leveraging our overhead with a focus on simplifying all of our operations, systems and processes to allow our associates to operate more efficiently. We continue to gain operating leverage through simplifying our systems, processes and procedures. As a result, our associates have become significantly more efficient and productive, resulting in our year-over-year personnel spend being flat where our volume increased by 7%.

We continue to leverage technology to reduce our customer acquisition cost spend by sourcing higher quality online customer leads. Our focus is on the quality of our internet leads, not just quantity. Through rigorous A/B testing of digital marketing strategies and tactics, we deliver higher quality leads to our Internet sales team. The result is our Internet leads, defined as someone who requests specific information and gives us their contact information, are up 50% over last year. The resulting high volume of high-quality leads reduces realtor spend and delivers more volume across the fixed cost of our sales platform.

I will conclude by echoing what you heard from both Stuart and Rick. We are laser-focused on improving our net operating margin, free cash flow and return on capital. To achieve these goals, our program is simple. Maximize efficiency. Be land-light. Have Everything's Included even-flow production with sales matched to the production pace. Drive direct cost down through strategic Builder of Choice partnerships. And use technology and leverage to reduce our SG&A.

Now, I'll turn it over to Diane.

Diane Bessette: Thank you, Jon, and good morning to everyone.

So let me summarize and reemphasize a few points from our third quarter and starting with Homebuilding. So looking at deliveries, you've heard that our deliveries increased 7% from the prior year and exceeded the upper range of June guidance by 2% as we benefited from a favorable interest rate environment.

Our third quarter gross margin on home sales was 20.4%, which was at the higher end of our June guidance. The prior year's gross margin was 20.3%, including CalAtlantic's purchase accounting and 21.9% excluding purchase accounting. Q3 2019 gross margins were impacted by lower average sales prices as we strategically repositioned our product to target more first-time homebuyers and lower-priced homes. Gross margin was also impacted by an increase of 60 basis points in sales incentives year-over-year. So incentives decreased sequentially by 30 basis points. Additionally, while construction costs were up 3% year-over-year, there was a decrease sequentially of 1.6% as we realized the benefits of our size and scale.

Our third quarter SG&A was 8.3%, which is the lowest third quarter SG&A percent we have ever achieved and was at the lower end of our June guidance. This compared to 8.5% in the prior year. The improvement, as Jon mentioned, was primarily a result of continued operating leverage due to size and scale in our market and our focus on technology initiatives.

Turning to new orders. New orders increased 9% from the prior year and exceeded the upper range of June guidance by 4%. Our cancellation rate for the quarter was 16%. And then looking at absorptions, absorption for the third quarter was 3.4 versus 3.1 in the prior year. And we ended the quarter with about 1,300 active communities.

And finally, for our Homebuilding joint venture land sales in the Other categories, we had a combined earnings of \$18 million, compared to a \$3 million loss in the prior year. The current quarter primarily benefited from \$12 million of gross profit on land sales and also \$12 million earnings of other income, largely related to the sale of two clubhouses, both as a result of our continued focus on cash generation. And this was partially offset by about \$10 million of losses from our joint ventures.

Now turning to Financial Services. So looking at the results in total, operating earnings were a record \$79 million, net of non-controlling interests compared to \$61 million in the prior year and the details as follows: mortgage operating earnings increased to \$57 million from \$34 million in the prior year. And as you heard us mention, mortgage earnings improved primarily due to a higher capture rate of increased Lennar deliveries as well as reductions in loan origination cost, driven in part by technology initiatives. These items more than offset the decrease in retail origination volume as a result of the sale of substantially all of our retail mortgage business in Q1 of '19.

Title operating earnings were \$18 million compared to \$22 million in the prior year. The decrease was due to the sale of the majority of our retail agency business and title insurance underwriter business to States Title in Q1 of '19, which resulted in a 56% decrease in title revenue. This decrease in revenue was partially offset by an increase in captive closed orders and a decrease in operating expenses.

Rialto Mortgage Finance operating earnings were consistent with the prior year at about \$4 million. A decrease in securitization dollar volume was offset by an increase in securitization margins.

And then turning to Multifamily. Our Multifamily segment had operating earnings of \$11 million, net of non-controlling interests, compared to a loss of \$4 million in the prior year. There was one building sale this quarter that resulted in the segment's \$13-million share of gains compared to one sale in the prior year that resulted in the segment's \$2-million share of gains.

And then on the Lennar Other category, this is the category for the legacy Rialto assets outside of Rialto Mortgage Finance and our strategic technology investments. Earnings were \$16 million in this quarter compared to \$10 million in the prior year. And this was largely driven by higher earnings related to the Rialto Fund Investments that we've retained.

And then finally looking at our tax rate, our tax rate for the quarter was 23.1%, which was lower than our guidance of 25.5%, primarily due to energy credits that our team was able to generate this quarter.

And then turning to the balance sheet. We ended the quarter with \$795 million of cash. And at the end of the quarter our homesites owned and controlled were 310,000 of which 70% are owned and 30% are controlled. There's an improvement, as Rick mentioned, from 25% controlled in the prior quarter. And as we've said, our year's supply owned decreased sequentially from 4.5 to 4.4.

Land acquisition spend during the quarter was \$691 million and land development was \$645 million. We had borrowings on our revolving credit facility of \$700 million, leaving \$1.7 billion of available capacity.

During the quarter, we retired \$500 million senior notes due in June, and since the acquisition as Stuart mentioned of CalAtlantic, we've retired \$1.6 billion of senior notes.

As we mentioned during the quarter, we repurchased 6.1 million shares of stock for a total of \$295 million, and this brings our repurchase activity to 8.1 million shares or \$395 million so far this year.

At the end of the quarter, our homebuilding debt to total cap ratio was 37.1%, which improved 300 basis points from the prior year and 120 basis points sequentially. Stockholders' equity increased to \$15.4 billion and our book value per share grew to \$48.40 per share.

So now turning to guidance. I'd like to give a little bit of guidance for the fourth quarter. Starting with Homebuilding. We expect new orders to be between 12,200 and 12,400. We expect to deliver between 15,800 and 16,000 homes. This estimate includes the impact of the hurricane that Stuart mentioned, as well as the acceleration of deliveries into Q3 that Rick referenced.

We expect our Q4 average sales price to be between \$385,000 and \$390,000. We expect our Q4 gross margin to be in the range of 21.25% to 21.5% and our SG&A to be in the range of 7.7% to 7.8%. And for the combined homebuilding joint venture land sales and other categories, we expect a loss - a Q4 loss of approximately \$20 million.

Turning to Financial Services. We believe our Financial Services earnings will be between \$68 million and \$70 million. We believe our Multifamily segment will be about breakeven. And for the other category related to the Rialto legacy assets and our strategic investments, we expect Q4 earnings to be between \$5 million and \$10 million.

We expect our corporate G&A to be about 1.4% of total revenues and we expect our tax rate to be about 25.5%. The weighted average share count for Q4 should be about 317 million shares. And this estimate does not include any additional share repurchases that we might opportunistically pursue. This guidance should produce an EPS range of \$1.81 to \$1.94.

In summary, we believe we are well positioned to continue to generate strong profitability, increased cash flow and improved returns for the balance of 2019 and continuing into 2020.

And now let's turn it over to the Operator for questions.

Coordinator: It is now time for the question-and-answer session for today's call. If you would like to ask a question, please press star 1. Please make sure that your phone is unmuted. Please limit yourself to one question and one follow-up until all had been allowed to ask. If you do wish to withdraw your question, please press star 2.

First question comes from Steven Kim from Evercore ISI. Your line is open sir.

Trey Morrish: This is actually Trey on for Steve. So first I wanted to ask little about on the orders front. The West, Central in your Texas region all were pretty good, up 10% or more. But the East appeared to be lagging a bit. Is there something unique in that geography or is there something a little bit more, you know, comp-related that's more difficult in the quarter? We're just wondering what's kind of going on there.

Rick Beckwitt: In the year ago period, we had a lot of new communities open in the quarter and we had a pretty strong sales period in the year ago. There's nothing going

on that's abnormal or unusual. I feel that the Eastern markets are strong across the board.

Trey Morrish: Okay. And then you highlighted this quarter that your closings benefited from a pull-forward deliveries and due to lower rates. And it's also something you talked about last quarter as well. I'm just wondering, is that something that is included - or that dynamic, is that included in your fourth quarter guide? Or is that something that could again ultimately be a little bit of upside to your numbers?

Rick Beckwitt: Yes, I think with regard to the acceleration of people's desire to close, you know, when rates move, people lock and they don't want to lose the opportunity. And we just saw some people do that in the third quarter. And if there is a similar phenomenon in Q4, then we'd expect something like that as well. But we haven't put that in our guidance.

Trey Morrish: Okay. Thanks very much.

Coordinator: Next question comes from Ivy Zelman from Zelman & Associates. Your line is open.

Ivy Zelman: Thank you. Good afternoon guys. Congrats on a great quarter. So, you know, it's been almost two years - roughly two years since you initially announced the acquisition of CalAtlantic and I thought it might be helpful maybe you can share with us, you know, with respect to the aspects of the integration, you know, where you've been most pleasantly surprised and where are there other areas that you still think there are untapped opportunities that you can capitalize on with the dominant scale that you have. And then I have a follow-up. So thank you.

- Jon Jaffe: Hi, Ivy, it's Jon. I'd say we're, most pleasantly surprised with how quickly and smoothly the integration went across the entire platform. So to me, it's not one particular area that stands out but everyone very quickly was on the same page. There's no confusion about do you turn left or right and a very quick transition to Everything's Included out in the communities to have our consumer-facing front all on the same page. Same thing as you look across our Internet digital marketing platform. Same thing as you look across our land acquisition discipline. Everybody really is in lockstep, pulling in the same direction. And I'd say that's what we're most pleased about.
- Rick Beckwitt: I guess I'd add to that, Ivy. You know, we had always assumed and expected that given the increase in scale and size in our markets that that would be a significant advantage. And if anything, we underestimated the benefit of that. And it really comes from all aspects of the business, access to labor, our cost structure and really on the land side.
- Stuart Miller: I think that - look, I think that the most remarkable part of two years, just two years passing since that announcement, and no disrespect intended, we don't even talk about the acquisition anymore. We are one Lennar. We're one company. And, you know, vestiges of integration, things like that are far behind us. I think that as one company, we're focused on using our size and scale to really leverage every aspect of our business. You hear about it a lot relative to land. You hear about it a lot relative to production cost, and you see a lot of leverage in SG&A. And all of those components are being driven by the fact that we've got size and scale and a fully integrated program as one company, unified program.
- Ivy Zelman: That's very helpful and sounds awesome. Hopefully there's a lot more to come from the scale and your dominant position.

Moving to one aspect of it with land, Rick, maybe this is for you, just to - with respect to the regional land developers that you've partnered with, I think you've talked publicly about three. You know, some of the clients I was chatting with at our Housing Summit, you know, we were talking about well why is it any different than, you know, another builder who's optioning lots from a land developer? And I thought it'd be helpful, one, if you can talk about, if you expand it upon the three and why is it an advantage, the relationship you have, because I think you own a portion of those companies. Maybe elaborate on that, Rick, if you would.

Rick Beckwitt: Yes. I think the key differential is the people that we're working with are experts in going through the entitlements and really finding great pieces of properties that are a game-changer. And if you think about our core business, you know, as a builder, we don't want to really play in the entitlement space. So these are regional folks that this is what they do. They find opportunities before anybody else can and we've worked with them to expand our land platform. And we have expanded them into other geographies. And it's working effectively.

Jon Jaffe: Ivy, it's Jon. I'd interject to that. You know, the strategic relationships and the differential between what you hear from other builders I believe is that these are long-term ongoing relationships that will continue to produce opportunities for us over time as compared to one-off option transactions with a developer doing a single parcel.

Ivy Zelman: Got it. Very helpful. Good luck, guys. Thanks for taking our questions.

Coordinator: Next question comes from Truman Patterson from Wells Fargo. Your line is open.

Truman Patterson: Hi, good morning everybody and nice results.

First, I just wanted to touch on order incentives. Could you just discuss how they trended through the quarter, you know, possibly the magnitude of the improvement from 2Q to 3Q? And I realize it might be difficult to parse out numerically but could you just discuss qualitatively how incentives trended by segment entry level and move up?

Rick Beckwitt: Yes we didn't have too much variability amongst the months in the quarter. And as we've always said, we're really focused on net pricing and focused on maximizing the value of our inventory and turning inventory. Our key focus, as Stuart, Jon, and Diane and I have said is we're very focused on return on investment. And so net margin is really what we're focused on.

Truman Patterson: Okay. Okay, thank you for that. When I'm looking out a year or so, I'm really trying to hope to understand where your growth will likely come from, you know, community count, absorptions. You're starting to replace your move-up communities with higher-absorbing entry level communities. You know, will that just lead to very modest community count improvement -- I believe you alluded to it on the call previously -- and, you know, growth will primarily come through increased absorptions? Or do you think you have enough owned land that you can really liquidate it and grow communities regardless at, you know, kind of a decent rate in 2020, call it like a mid-single-digit clip?

Rick Beckwitt: Yes. We're expecting to see community count growth going into 2020, progressing through the year. And with our focus on the entry level and lower priced market, absorptions are going to be stronger given the fact that there is higher velocity in the entry level market.

Truman Patterson: Okay. Thank you, guys.

Coordinator: Next question comes from John Lovallo from Bank of America. Your line is open.

John Lovallo: Hey guys. Thank you for taking my question. First one, I believe last year you provided delivery margin and SG&A outlook for 2019 during the third quarter. Is there any reason why you guys decided not to do that today?

Stuart Miller: There's no specific reason. We've just traditionally given guidance for the following year in the fourth quarter. Last year, we made a decision strategically to accelerate that, and we've just gone back to our normal practice. As I said in my comments, we are optimistic about 2020. It's just a little premature for us to do - to give specific guidance. And I think that as we have traditionally done in the fourth quarter, we will give the guidance that we normally give.

John Lovallo: Okay. You know, that sounds good. And then in terms of, you know, orders, are there any comments, maybe at least directionally you can give us in terms of September and how that may have trended?

Stuart Miller: Yes. So, historically, we've not given additional guidance past the quarter's end. But as we said in our remarks, the market has been very strong and it has continued to be improving. And I think we'll go about that far. Don't want to set a new standard but it's clear that the trend through the quarter was positive with August being our most robust month and continuing into the fourth quarter we're seeing additional strength.

John Lovallo: Thank you guys.

Coordinator: Next question comes from Mike Dahl from RBC Capital Markets.

Mike Dahl: Hi. Thanks for taking my questions.

Stuart, maybe just to pick up on that last comment, I think, you know, clearly your business is seeing the strength in the numbers and it's great to hear the positive commentary. One of the pushbacks we still get to the overall group is just the broader macro concerns and whether or not these are really seeping into consumer behavior at this point. So, can you give us a little more color on, you know, what you're hearing from the field as buyers are balancing, you know, affordability being restored versus, you know, maybe or maybe not being impacted at all by some of the headlines out there?

Stuart Miller: You know, I think that we talk about this a lot. It's easy to get a little confused in today's market. There's a lot of noise in the political scene and, you know, it certainly feels like it's creating crosscurrents. But as we look to the feedback that we're getting real-time from the customers coming to our Welcome Home Centers and talking to us about their thought process, their future, we're still seeing that the underpinnings, the fundamentals of the economy are driving consumer sentiment. And perhaps we're more sensitive to the noise than the actual consumer is.

You know, low unemployment, generally positive job growth, a fairly strong economy, all of these things seem to be driving consumer sentiment more than some of the new stories that we see that seem to be politicized. And so we're - you know, as we've noted, we've seen growing strength as we went through our third quarter. And that seems to be the dominant direction. I know that there's a lot of question about upcoming potential recession and things like that. Our customers don't seem to be viewing it that way and I think that the housing market in general seems solid and strong and continuing to improve.

Mike Dahl: Okay that's helpful and good to hear. My second question then just specifically with respect to the fourth quarter order's guide, if we heard it correctly, it sounds fairly robust in terms of the growth there and, you know, there is an easier comp. But just on the question of absorption versus community count, maybe a little more detail - the comment was made growth in community count into 2020. How should we think about the balance of, you know, community count versus absorption in - within that fourth quarter order's guide specifically?

Stuart Miller: So, you know, look, community count is a very complicated number. It's got a lot of moving parts. So into the fourth quarter, we're kind of suspecting that our community count is going to be about where we are and we'll see a little bit more absorption. As I noted in my comments, our guidance for the fourth quarter has been moderated by the production flow-down that we saw relative to all the preparation work all the way up the Eastern seaboard that had to take place relative to the hurricane coming through. And that really shut down a few weeks of production. So our guidance might have been higher had we not had that kind of blip along the way.

You know, In terms of community count as we look into 2020, I think that what we've probably understated is the really strong relationships that are driving our land strategy overall, all the way from the way that we're migrating from owned to option programs to the access to new communities to the kind of regional and sometimes national relationships that will define the way that we own and hold land and are prepared for growth in the future. These are evolving stories that really come down to very, very strong long-term relationships that have been enhanced by our additional size and scale.

And the two, relationship and size and scale, are working hand-in-hand to give us a great deal of confidence that as we think about community count going into 2020, we are on an upward trajectory. And that's going to define our growth prospects as we go forward.

Mike Dahl: Thanks for the details.

Stuart Miller: You bet.

Coordinator: Next question comes from Michael Rehaut from JPMorgan.

Michael Rehaut: Hi thanks. Good morning everyone and congrats on the quarter. First question, you know, Stuart, I just wanted to expand a little bit on what you just said before regarding, you know, the land relationships, the shift towards lot optioning, the, you know, ability in sourcing of land and communities going forward and kind of how that's allowing you to at least, you know, directionally say you expect to grow community count next year.

You know, with the increase of the lot-optioning target from 40% to 45%, I guess maybe just asking it perhaps a little bit more bluntly but, you know, number one, I was hoping to get a little bit of a time frame of when you'd hope to achieve that 40% to 45% range. I think, you know, in the past, the 40% number was a little bit more perhaps over the next, you know, a couple of years, let's say, or maybe the next 18 months even if we're still talking about that same time frame, let's say now through the end of next year or even 2021.

And secondly, you know, as part of this question just on your community count comments and access to land, I believe you'd also talked about, you know, with the overall soft pivot that you've been doing over the last, you

know, two or three years, most recently kind of a unit volume growth objective of perhaps low-to-mid single digits. I was curious if, you know, the enhanced access to land changes that type of growth, you know, dynamic that, you know, perhaps if you're opening yourselves up to a broader, you know, enhanced set of land developers and stronger relationships, if that changes that growth calculus at all.

Stuart Miller: Okay. So that's a lot of questions embedded in one there, Mike. So let me see how I can do. Let me start at the end and say that we're really not changing our growth trajectory. We are refining the way that we get there, and we're really using the expanded relationships that we've got and size and scale to moderate our growth. But the access to land that we are - that we're working on and working with right now really enables us to grow as much as we perhaps want to. But we're constraining that growth in order to do it in the most effective way possible.

And by constraining growth, what we're enabling of ourselves is the ability to make that migration from a land-heavier to a land-lighter strategy, which is going to generate very strong cash flows that enable us to manage our balance sheet, our debt levels and our return of capital strategically. So we're really pretty enthusiastic about that.

Again, the relationships that we have that are long-term relationships, together with the size and scale that we've amassed, gives us a lot of optionality. And we know that we've highlighted a fairly aggressive target in terms of migrating from what was 20% to 25% to 30% option versus owned land relationship to a 40% to 50% level over the next couple of years. And that's an aggressive standard. But when we look at what's in our hopper and the things that we're working on and understand that when this management team focuses on something, we have a lot of tools in our toolbox. We have people

who have deep, rich relationships that we can activate that stuff and make these things happen. And that's what's happening behind the scenes.

What we have in the hopper right now gives us a pretty good sense and confidence about being able to set high standards and expectations and then deliver on them. That's what you've seen from us in the past. That's what you're going to see from us now.

Michael Rehaut: No, great. Thank you, Stuart. I appreciate that. I guess if I could just - you know, I know this first question, multifaceted but I'll see if I can sneak another one and if you allow. On the gross margin side, you know, obviously it's an encouraging guide for the fourth quarter and you're kind of continuing to see that recovery throughout this year as many builders have, you know, coming off of the first half of the year when the industry, you know, kind of processed, you know, some of the higher incentive levels of the back half of '18. Should we be thinking of kind of the 21% - low 21% as kind of a new reset baseline at this point given, you know, how the housing market has normalized and incentives have, you know, kind of receded off of those higher levels 6 to 12 months ago as we go into 2020?

Stuart Miller: So, you know, look, there are some moving parts in this and I'm going to let Rick kind of directly answer the question. But I want to highlight one thing first and that is, look, land prices generally are and have been moving up. And then the migration toward a land-lighter strategy generally means you're buying more of a retail priced land asset underneath each and every home. What is exciting to us and remarkable is as Jon properly highlighted, our size and scale is helping us offset some of those natural increases in price with some reductions in our production cost, reductions in our SG&A, to get to a net margin that is really consistent and strong going forward.

So, Rick, maybe you'd like to weigh in on the direct margin question.

Rick Beckwitt: Yes, so Stuart is exactly right. There are a lot of moving pieces with regard to margin as we look at 2020 and '21. You know, our focus on increasing returns has an impact on the gross margin. We will be taking land very much closer to the start of the construction, and as a result there's a trade-off between gross margin - and I've said in the past, it could be 100 basis points, 150 basis points. But returns go up exponentially. And, you know, we believe that that's an important thing for us to focus on.

In addition, as we move down the price curve, the entry level homes generally have a lower margin but much, much higher IRRs associated with them. So when we'd come to the fourth quarter, we'll give you guidance on where we think we'll be for 2020. But all in all, it will be a really strong profitable year.

Diane Bessette: And hey, Mike, this is Diane. Let me just take a minute while we're talking about the fourth quarter. My apologies. Deliveries for the fourth quarter should be 15,800 to 16,000 homes. So I just wanted to clarify that.

Michael Rehaut: Great. Thanks so much guys.

Coordinator: The next question comes from Buck Horne from Raymond James.

Buck Horne: Hey thanks. Good morning. I wanted to see if you can just go in a little bit more detail on the single-family rental community platform that you're developing. And is it something that you would envision - it sounds like you're going to do it without land investment or lease-up risk. But would you actually consider expanding it to, you know, buy some land specifically targeted for that type of project? And I guess I'm also curious what kind of

addressable - total addressable market you think is out there for the build-for-rent product?

Stuart Miller: Listen I'd say this, I want to make clear that our single-family for rent program is an extension of our core business and it really is an asset-sensitive extension of that business that enables us to expand our core business without the risk that we're not becoming - it's not a version of our multifamily business, we're not building a new ancillary business. It's a production-oriented business as an extension of our core.

And additionally, and I think Rick highlighted it very well, and that is, you know, one of the biggest problems that we have in the country right now is affordable and workforce housing. And the single-family for rent business is becoming one of the big solutions. And we are part of that solution. We have had intense inquiry from participants who want to build entire communities of single family for rent where we can do it effectively, efficiently and with high returns, and we can participate, though we're not taking either the land risk or the lease-up risk. And this is a really positive program for us.

Rick, why don't you...

Rick Beckwitt: Yes. You know, directly to answer your question, you know, our primary focus is doing it in communities that are owned by a third party. That's our highest return on investment. It allows us to leverage our overhead. It allows us to build a very efficient program and build that scale fast. In addition to that, we are looking at doing single-family rental as an additional product offering in some of our existing communities, having it be a section of the community to increase the pace and return on investment in those communities.

So it's going to be a combination of things. But as Stuart said, this is our core business. We're building, selling and closing the homes and doing it fast.

Jon Jaffe: Okay this is Jon. I just would add one other point to this is we have complete optionality since this is the same product as we're building for sale to go whatever direction makes the most sense in terms of meeting the market demand and producing the highest returns for us.

Buck Horne: That's extremely helpful. Thank you guys. I'll drop - given the audio problems, I'll pass it on to the next one.

Stuart Miller: I don't think it was your fault, Buck. I think it was something on our end. But thanks for your questions.

Buck Horne: Thank you very much.

Stuart Miller: Why don't we take one more? Why don't we take one more?

Coordinator: Okay. Last question comes from Matt Bouley from Barclays. Your line is open sir.

Matt Bouley: Hey. Good afternoon. And thank you for fitting me in here. So just back on the entry level mix and the, you know, the sales pace implications, I think, Rick, you mentioned that you're in about 40% of the business today in terms of entry level, which kind of looks like where legacy Lennar was pre-CalAtlantic. So just - and I'll leave it here. This is my only question. As we look at 2020, just, one, kind of any sense of where that entry level mix will be next year based on the communities you've got coming on? And, two, you know, you mentioned the sales pace should improve as a result but are you

actually thinking that you can reach sales pace levels that are, you know, accordingly consistent with where legacy Lennar was? Thank you.

Rick Beckwitt: Well, with regard to the mix in 2020, you know, I did say that we'll be - it'll be a higher percentage of entry level, probably moves up, you know, 2% to 3%, 4%-ish, depending on when those communities come online. You know, we've really targeted across the board a lower price point. You can see it in our sales orders in every geographic segment of the company. And, you know, it's primarily being led by Texas and some of the Florida markets. But there is a - we've really worked on a highly engineered efficient floor plans that we're just rolling out everywhere.

Stuart Miller: You know, and our single-family for rent program and strategy will add to the change and the migration in that mix.

Look, as we come to conclusion here today, let me just say that there are a lot of moving parts in our business that are reflected in the third quarter as all moving in the right direction. And I think that that's what you're hearing from the management team right now is we're enthusiastic about the business, we're enthusiastic about the market and how it's shaping up as we look towards 2020. And we think that the business is on a really good track to make the changes, to make the programs and position the pieces to really have an exciting year ahead.

So thank you for joining us. We look forward to reporting our fourth quarter.

Coordinator: That concludes today's conference. You may disconnect at this time. Thank you and have a great day

END