

LENNAR CORP

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11:00 am EST

Coordinator: Welcome to Lennar's Second Quarter Earnings Conference call. At this time, all participants 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 Alexandra Lumpkin for the reading of the forward-looking statement.

Alexandra Lumpkin: Thank you, and Good morning. Today's conference call may include forward-looking statements including statements regarding Lennar's business, financial conditions, results of operations, cash flows, strategies and prospects.

Forward-looking statements represent only Lennar's estimate 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 uncertainty.

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 press release and our SEC filings. Including those under the caption risk factors contained in Lennar's annual report on Form 10K most recently filed with the SEC. Please note that Lennar assumes no obligation to update any forward-looking statements.

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

Stuart Miller: Very good. Good morning everyone, and thank you for joining us. This morning I'm here in Miami, and I'm joined by Jon Jaffe, our co-CEO and President, Rick Beckwitt, our co-CEO and President, Diane Bessette, our Chief Financial Officer, David Collins, our Controller and Vice President and Bruce Gross, CEO of our Lennar Financial Services. And of course Alex, who you just heard from.

As usual, I will give a macro and strategic overview. After my introductory remarks, Rick is going to talk about our markets around the country, Jon will update our land program and supply chain and construction costs. And as usual Diane will give a detailed financial highlight.

And as noted in our press release give some very limited boundaries to assist in go forward-thinking and modeling. And then of course we'll answer as many questions as we can. Please limit to one question and one follow-up.

So let me begin and start by saying that we're very pleased to announce another hard fought and well executed quarterly performance by the associates of Lennar. Throughout our second quarter we continued to sell homes and still offset higher land, labor and material costs.

Our gross margin as reported was 29.5%. Net margin was 23.4%. They continued to drive very strong cash flow and bottom line result as we continue to refine our business model for durability with a very efficient SG&A of 6.1% which is a 150 basis point improvement over last year and a record for the third quarter.

With this strong performance, and cash flow, we have continued to fortify our balance sheet with \$1.3 billion of cash, nothing drawn on our revolver and a 17.7% debt to total cap rate ratio as compared to 23.1% last year.

Accordingly, we're very well positioned to pay down another \$575 million of debt later this year as it comes due and further strengthen our balance sheet.

We also managed our sales price and pace through the second quarter and increased new orders by 4% year over year even though we began to see signs of weakening in the overall market. This weakening has continued into the third quarter.

The housing market has cooled as expected in response to the Fed's aggressive and rapid reaction to inflation. The resulting very rapid, almost doubling of the 30-year fixed rate mortgage rate in six months has had the desired effect of slowing price appreciation and moderating demand by increasing monthly payment costs and reducing affordability.

While the market has cooled it is clearly not stopped. Demand remains reasonably strong as buyers still have down payments and have attractive credit scores and can qualify.

Household formation has continued to rise. And although we have adjusted some prices in many markets those prices remain higher on a year over year basis. Buyers are seeking shelter from inflationary pressures as scarce rentals drive rents higher.

Supply remains limited across the country and the need for affordable workforce housing continues to be at crisis levels. Clearly production must catch up to the growing household numbers as production of dwellings over the past decade has lagged prior decades by as many as 5 million homes.

Nevertheless, the rapid increase in interest rates, together with price appreciation, have created, at least, sticker shock and perhaps a more structural cooling of demand. In a few minutes Rick is going to give a more detailed overview market by market review that will give a more comprehensive snapshot as to what we have seen to date.

Although these preliminary reflections of market conditions are not dispositive of the state of the market indicators have been building since the Fed's tightening began. And given the Fed's expressed conviction to combat inflation by the definitive statements made recently it seems that these trends will harden as the Fed continues to tighten until inflation subsides.

While we can choose to fight against the trend the reality is that the market has been changing, and we are getting ahead of it by making all necessary adjustments. So what is the playbook going forward?

We're going to keep it simple, and we're going to adhere to our core strategies. To begin, we are going to sell homes adjusting price, pricing to market conditions and maintaining reasonable volume.

We've discussed over the past years that we have had a housing shortage across the country. We will continue to build as prices moderate and adjust in order to fill that shortfall and provide much needed workforce housing across markets.

As we have noted many times in the past, whether the market is improving or declining we deploy our dynamic pricing model week by week to price product to current market conditions in order to maximize pricing and margin while we maintain a carefully limited inventory level. As the market moves we will continue to be responsive.

In sync with selling homes we will continue to leverage our extraordinary management team across the country and improve our cost of doing business. We have seen quarter over quarter improvement in our SG&A over the past years, and we expect to drive efficiencies through technology and process improvement to offset market adjustments wherever possible.

Next, we will continue to focus on cash flow and bottom line to protect and enhance our extraordinary balance sheet. Our great success over the past years derives from the successes around careful land management and inventory controls which have driven cash flows, enabled us to reduce our debt, repurchase shares of stock and drive shareholder returns.

In the second quarter we repurchased another 4.1 million shares of stock for approximately \$320 million and drove our return on equity to 21.4%, a 260 basis point improvement over last year.

Finally, we will conclude our long planned spin off by year-end. As we have continued to refine the three verticals of our spin company we will spin a mature asset management company into the public markets along with billions of dollars of assets under management that we've previously held on Lennar's books.

The final spin of our new company, which we will call Quarterra, will trade under stock symbol Q. And as we have noted before will be an asset light asset management business that will have a limited balance sheet.

By finalizing the spin we will further reduce Lennar's asset base by another estimated \$2.5 billion which will drive higher returns on our assets and equity base and will not result in a material reduction of either our bottom line or our earnings per share.

We're very excited about the future prospects for Quarterra as this will be the second spun company in our history. And we have great confidence in the prospects for its future.

So let me conclude by saying that while the market might be shifting and adjusting to a new higher interest rate environment, we at Lennar are prepared. We are extremely well positioned financially, organizationally and technologically to thrive and to succeed in this evolving housing market.

We recognize that interest rates are rising and inflation continues to be a legitimate threat. We know that the Fed is determined to curtail inflation, and this will take some time. But we also know that we can adjust as the market changes, and we will.

We also know the difficulties in the supply chain continue to persist. And we know that land and labor remain in short supply. And we know that cash flow matters and that a strong balance sheet enables us to operate from a position of strength.

As we look to the remainder of 2022 we recognize that there are challenges in the market that we must carefully regard. Expect that we will meet the challenges and that we will continue to adjust to maximize opportunity and drive Lennar into an ever better future. With that let me turn over to Rick.

Rick Beckwitt: Thanks Stuart. As you can tell from Stuart's opening comments the housing market has been reacting to a significant increase in mortgage rates, increased sales prices, continued inflation and the impact of the declining stock market.

These changes accelerated during the quarter with many marking the most pronounced impacts. With this in mind I would like to focus my comments

today on the monthly changes during our quarter, the current sales environment in our market and our strategic and operating focus as a company.

During the second quarter our new sales orders increased 4% from the prior year on flat year over year community count. Our sales pace per community increased from 4.8 to 5 sales per month.

We continue to sell our homes later in the construction cycle to maximize prices and offset potential cost increases. During the quarter we saw year over year increases in new sales orders in each month of the quarter with a variant of less than 125 sales orders between each monthly total.

Our sales incentives on new orders during the second were down ten basis points year over year. However, the percentage did increase sequentially each month during the quarter with May new sales order incentives totaling 1.6% of the gross sales price of the home.

While the sales percentage in May marked the high point during the quarter, it was still relatively low from a historical perspective. In fact, sales order incentives in May were slightly lower than the average new sales order incentive for the latest 12 months.

Our cancellation rate during the quarter totaled 11.8% which increased sequentially during the quarter, but was significantly below our long term historical average. We ended the quarter with only approximately 250 completed homes that were installed across our national footprint putting us in a great position in a softening sales environment.

So far in June new orders, traffic, sales incentives and cancellations have worsened in many of our markets due to a rapid spike and mortgage rates and headwinds from negative economic headlines. Many markets have also slowed as we've entered a seasonably slower part of the year.

I'd now like to give you some color on our markets across the country. They really fall into three categories, one markets reflecting no to minimal impacts, two markets reflecting modest impacts and three markets reflecting more significant impacts.

During the second quarter, and so far in June, we had 19 markets that continue to perform well. These include our six Florida markets, New Jersey, Maryland, Charlotte, Indianapolis, Chicago, Dallas, Houston, San Antonio, Phoenix, San Diego, Orange County and the Inland Empire.

All of these markets are benefiting from extremely low inventory and many are benefiting from a strong local economy, employment growth and in migration. While these markets have continued to be strong our sales pace and pricing power has started to flatten or has flattened in each of these markets. To maintain sales momentum we have offered mortgage buy down programs and normalized markets incentives.

Our category two markets, which reflect a modest softening in pricing and a slow-down in the markets, includes ten markets. These include Atlanta, Colorado, Charleston, Myrtle Beach, Nashville, Philadelphia, Virginia, the Bay Area, Reno and Salt Lake City.

In each of these markets traffic has slowed, and we've seen an uptick in cancellation rates. And while inventory is limited in each of these markets

we've had to offer more aggressive financing programs and targeted price reductions to keep our sales pace in line with our production schedule.

Selectively reducing the sales price to solve for a mortgage payment that works for our buyers has worked well in these markets. Notwithstanding these pricing decreases net pricing remains higher than year ago periods.

Our category three markets, which reflect a more significant market softening and correction, includes seven markets. These include Raleigh, Minnesota, Austin, Los Angeles, the Central Valley, Sacramento and Seattle's. I'd like to spend a few minutes discussing these markets and what we're doing strategically from a sales plan.

Raleigh was an extremely strong market in the second quarter but softened significantly at the beginning of June. This stems from a combination of higher mortgage rates, steep price increases over the last two years and some jobs concerns in the tech sector.

We believe pricing pressure will continue until the market resets. And we've been reducing pricing and offering aggressive mortgage buy down programs. Our pricing adjustments have started to take hold and sales activity has begun to stabilize.

On a positive note cancellation rates have not been a problem, inventory is limited and our net new order pricing is still up on a year over year basis. As a result we have room for any needed future pricing adjustments.

The Minnesota market has been very challenging. Buyers have always been conservative in this market, and as rates have increased there have been a strong push back against current pricing.

There's very little immigration in Minnesota which makes pricing much more challenging because we have a limited pool of only local buyers. We have reacted with strong price reductions, competitive mortgage programs and we're solving to a mortgage payment that works, which is starting to rebuild sales.

Austin has been the most impacted market in Texas following back to back years of 40% plus appreciation and bidding wars on available inventory. Higher rates in June and headlines on the stock market declines and the distressed national economy has sidelined many buyers who are waiting for a reset in home values.

While inventory is limited cancellation rates have increased, and we've reduced prices in many communities on a home by home basis and have offered extremely competitive mortgage programs. These pricing adjustments are starting to generate increased sales activity. Fundamentally Austin is positioned for long term growth with low unemployment, high apartment occupancy, low new home inventory and strong projected job growth.

Our communities in Los Angeles, Central Valley and Sacramento have experienced a significant slowdown with traffic dropping off considerably in late May and into June. With the spike in interest rates buyers in these markets have been extremely credit challenged and cancellation rates have increased. We've adjusted prices, are using financing incentives and in some cases have included [inaudible] solar systems as part of our home package to rebuild sales.

Net new order prices remained higher than the year ago period and completed inventory for the most part has not been a problem. The issue continues to be

a reset in pricing to solve the mortgage payment that works in these markets. This is consistent with what Stuart said in his opening remarks.

Seattle was one of the strongest markets in the country over the last few years. The market saw strong immigration, solid job growth and sales prices that grew approximately 20% annually in each of the last two years.

While market fundamentals with limited land supply and low inventory remain extremely strong, buyers have pushed back for a reset in pricing. The higher priced and highly sought after locations around Seattle has seen a significant pull back in sales in May and early June.

This pull back is a result of both continued price appreciation in the first quarter causing concern over values being overpriced and stock market corrections which have had a direct impact on employee stock compensation plans. We've adjusted prices in some communities to keep lower pricing and have seen a sales uptick with this correction which demonstrates the underlying strength of the market. Once again, in this market we are at prices that are still significantly higher than the year ago period.

I hope this gives you a better picture of our markets across the country and what we're doing to keep sales activity going. The markets remain very fluid, and we are making strategic decisions and adjustments every day.

As we've said in the past we're going to keep our home building machine going, maintain our start pace and price our homes to market. I'd like to now turn it over to Jon.

Jon Jaffe: Thanks Rick. This morning I'll discuss our land position and give an update on the status of the supply chain. I will be brief as I know that sales and interest rates dominate the interest of our investors.

We are pleased with the excellent progress we continued to make our land light strategy as evidenced by our controlled home site percentage increasing to 62% at the end of the second quarter from 50% last year. We also continue to make progress by reducing the years of supply of owned home sites to 3.1 years at the end of the second quarter down from 3.3 years last year.

To date we have worked with our Land Strategies Group which will become a vertical of Quatterra to continue to reduce our years of land owned even lower. Using this strategy we've cycled some \$10 billion of land and land development from owned to controlled as we refine the supply of just in time home sites to our home building machine.

Our extreme focus on our land lighter model saved us a significant amount of cash spend on land acquisition during the quarter. We ended the quarter as noted with \$1.3 billion in cash, no borrowing on our \$2.6 billion revolver and homebuilding debt to capital of 17.7%. As Stuart noted, we're very well positioned to manage through the changing interest rate environment with our excellent asset land light position and very strong balance sheet as a foundation for that position.

Turning to the supply chain, and it's well documented challenges for the industry, our second quarter started presenting some favorable news. There was still intermittent disruptions and an increase in construction costs, but for the first time since the disruptions began we saw a flattening in cycle time.

Over the past four months cycle time has expanded by only five days which we believe signals of peak. Additionally, about 25% of our markets experience cycle time reductions in the second quarter compared to the first quarter. There are still challenges that occur, but we're managing them effectively as evidenced not only by this flattening of cycle time, but also by being above the high end of our guidance for second quarter closings.

Our direct construction cost in the second quarter were up 1.6% sequentially and 20% year over year, both lower than the comparable increases for the same periods in the first quarter and fourth quarter of 2021. Rising labor costs accounted for all of the increase in the second quarter.

Material costs were lower due to the lower priced lumber from starts in the second half of last year. We expect cost will rise again in the back half of 2022 as increases in lumber that spike in Q1 will flow through those closings.

The current drop in lumber prices that we're experiencing, which started near the end of our second quarter, will lower the cost of our starts in the second half of this year and related deliveries in the first half of 2023. Thank you, and I'll turn it over to Diane.

Diane Bessette: Thank you Jon, and good morning everyone. So Stuart, Rick and Jon have provided a great deal of color regarding our home building performance therefore I'm going to spend a few minutes on the results of our other business segments, and our balance sheet and then review our thoughts for Q3.

So starting with financial services, for the second quarter our financial services team produced \$104 million of operating earnings slightly above the high end of our guidance. And then when you look at the details between

mortgage and title, mortgage operating earnings were \$74 million compared to \$92 million in the prior year.

As we've indicated for several quarters, and as has been greatly documented in the media, the mortgage market has become extraordinarily competitive for purchase business as refinance volumes have all but halted and resale inventories have declined. As a result, secondary margins have been decreasing. This was the primary driver for our lower second quarter earnings.

Title operating earnings were \$30 million compared to \$24 million in the prior year. Title earnings increased primarily as a result of higher premiums driven by an increase in average sales price per transaction.

And then turning to our Lennar other segment, for the second quarter our Lennar other segment had an operating loss of \$108 million. The loss was primarily the result of non-cash mark to market losses on our public company technology investments which totaled \$78 million. The remaining loss was primarily related to other strategic investments in this segment.

As we have mentioned before we are required to mark to market many of our technology investments that are publicly traded and that valuation will fluctuate from quarter to quarter. However, we continue to believe that these technology partnerships provide significant operational efficiencies for both our home building and financial services platforms and greatly improve our home buyers experience.

And then turning to the balance sheet. As we've mentioned we ended the quarter with \$1.3 billion of cash and no borrowing on our revolving credit facility for a total of \$3.9 billion of homebuilding liquidity.

And one note regarding our credit facility, last month we successfully amended and extended this facility. We now have almost \$2.6 billion of commitment, \$350 million matures in 2024 and \$2.2 billion matures in 2027. We were pleased with the execution which was greatly enhanced by our investment grade rating.

During the quarter we, as Jon mentioned, we continued to focus on becoming land lighter. As a result at the end of the quarter we owned 193,000 home sites and controlled 319,000 home sites for a total of 512,000 home sites.

This portfolio of home sites provides us with a strong competitive position for continued market share expansion. Our home sites controlled increased to 62% from 50% in the prior year. And our years owned improved to 3.1 years from 3.3 years in the prior year.

Land transactions may fluctuate quarter to quarter, but progress is made year over year. We are still on track to reach our goal of 2.75 years owned and 65% home sites controlled by year-end.

And we remain committed to our focus on increasing shareholder returns. As we mentioned during the quarter we repurchased 4.1 million shares totaling \$321 million.

Additionally, we paid dividends totaling \$111 million during the quarter. Our next senior note maturity is \$575 million, which is due in November of this year, and we have no debt maturity due in fiscal 2023. The results of all these transactions with the home building debt to total capital of 17.7%, which improved from 23.1% in the prior year.

And then just a few more points on our balance and return our stockholders equity increased to \$22 billion. Our book value per share increased to 74.12. Our return on inventory was 30.5%. And our return on equity was 21.4%.

In summary our balance is strong and positions as well for the future. And so with that brief overview I'd like to turn to our thoughts for Q3.

As we mentioned in our press release it is difficult to provide the more targeted guidance that we typically offer given the uncertainty and market conditions. So alternatively we thought it would be more appropriate to provide very broad ranges to give some boundaries to each of the components of our third quarter.

So starting with new orders we expect Q3 new orders to be in the range of 16,000 to 18,000 homes. We anticipate our Q3 deliveries to be in the range of 17,000 to 18,500.

Our Q3 average sales price should be slightly higher than our Q2 average sales price which as a reminder was 483,000. We expect gross margins to be in the range of 28.5% to 29.5%. And we expect our SG&A to be between 6% and 6.5%.

For the combined homebuilding, joint venture, land sale and other categories we expect a loss of about \$10 million. And then we anticipate our financial services earnings for Q3 will be in the range of \$70 million to \$75 million as market competition for purchase business continues to increase.

We expect earnings of about \$20 million for our multifamily business. And for the Lennar other category we expect a loss of about \$20 million. This guidance does not include any potential mark to market adjustments to our

technology investment since those adjustments will be determined by their stock prices at the end of our quarter.

We expect our Q3 corporate G&A to be about 1.4% of total revenues. Our charitable foundation contribution will be based on \$1,000 per home delivered. We expect our tax rate to be approximately 24%. And the weighted average share account for the quarter should be approximately 288 million shares. So when you pull this together, this guidance should produce an EPS range of approximately \$4.55 to \$5.45 per share for the third quarter.

And then turning to the full year as we mentioned, we're maintaining our previous delivery guidance of approximately 68,000 homes for the year. However, at this time recognizing that market conditions are fluid, we will not be providing updated guidance for the other components of earnings. We do look forward to updating our thoughts for Q4 on our next earnings call. And with that, let me turn it back to the operator.

Coordinator: Thank you. We will now begin the question and answer session of today's conference call. We ask that you limit your questions to one question and a follow-up question until all the questions have been answered. If you would like to ask a question please unmute your phone, press Star 1 and record your name clearly when prompted.

If you need to withdraw your question, you may you Star 2. Again that is Star 1 to ask a question. And our first question comes from Stephen Kim at Evercore ISI. Please go ahead.

Stephen Kim: Yes, thanks very much guys, exciting times, appreciated all the color you gave on the call. There was a couple of comments you made about incentives and

lumber. And you also gave a range I guess, for 3Q gross margins. And so I was curious, it was a pretty strong 3Q gross margin number.

And I was curious how much of a sequential increase in incentives is envisioned in that guidance. I think you said incentives were running at 1.6% in May. So I'm kind of queuing off of that. And then also how much of a headwind in - from lumber, because I think Jon mentioned that there was going to be some of that. So in both cases I'm talking, you know, sequentially from what you experienced in 2Q?

Jon Jaffe: Hey Stephen, it's Jon. So relative to incentives, you know, they're still relatively low. You know, as Rick mentioned, they're coming about 1.6% or that's what we're seeing in today's market. You know, some of those markets as they continue adjust, there might be a little bit more.

In lumber what's flowing through our numbers and is already in our backlog which gives us comfort, our guide on gross margins is about a \$6 a square foot increase from our starts earlier in the year. So we have good visibility to exactly what that is.

Stuart Miller: Yes, I - let me just add to that Steve with what you're seeing flowing through our third quarter is already in backlog. So it's not just lumber that's in backlog, it's also many of the incentive.

There will be some cancellations and some rotation through, and so we'll see some movement through the quarter. And as we noted, given the changing environment, it's going to be hard to say what actually the numbers are going to round out to be. There's going to be some averaging.

And just remember that on the third quarter, we have a pretty good sense of visibility given the fact that a lot of our backlog is focused on the third quarter.

Stephen Kim: Yes, that's a fair point. And I - so I guess in regards to that I was curious as to the exposure of cancellations. You know, a lot of the builders, well all the builders really that you guys have sort of provided in your documents, you know, how much earnest money deposit they collect from their customers as a percentage. And I - we look at that as a percentage of the ASP, was curious if you could talk about that.

And the other part of my question relates to the single family rental business, because Rick, when you were going through all your markets, it was interesting, you didn't really talk much about rents, but obviously that's an important part of the equation.

I know that the single family rental appetite to acquire units has been really strong, but people are talking about whether that bid's going to disappear in the current environment. And so I was wondering if you could just sort of talk about the ability of you, of your company to actually benefit, unlike in cycles past from some of the rising rates pushing business into the rental arena?

Rick Beckwitt: Well, first let me address the question on backlog and deposits. One of the things that our mortgage company has done is really attack and lock our Q3 and Q4 backlog. We've had a very concentrated effort to make sure that people have mortgages in place so that when closing comes up, they're good to go.

Stuart Miller: Not just mortgages in place, but interest rates locked.

Rick Beckwitt: Interest rates locked.

Stuart Miller: Yes. And what was the back part of that question Steve?

Stephen Kim: It was referring to the single-family rental appetite for...

Stuart Miller: Single-family.

Stephen Kim: ...newly built homes.

Stuart Miller: So let me say Steve that, you know, the entire rental market is interesting right now. You know, we've, we've talked a lot over the quarters about housing shortage. The fact is that even as interest rates go up, people still need a place to live, household formation remains strong. I know you've covered a lot of these dynamics.

And at the end of the day, we're, we're probably going to push more people from home ownership towards rental. That will mean multifamily, traditional multifamily, as well as a single-family for rent. And I think there's, there's going to be some dynamic shifting that moves around in all of these areas.

To the extent that we move more people out of home ownership and towards rental, it increases the demand for an already supply constrained component of the market. That's the rental market, both SFR and traditional rentals.

If you look at rental rates and where they have been moving over the past year, both on the traditional rentals and the single-family for rent, you've seen pretty aggressive movement upward in rental rates. That is a function of limited supply and growing demand.

So how this is going to play out is part of what we point to as some of the confusion or some of the question marks that sit out there over the next quarters as the market reconciles to a new interest rate environment, rental rates that are moving and shifting and even the SFR buyers are going to have to rethink what their model looks like. They have higher interest rates in their capital stack, but they also are getting higher rental rates from their customers. So we're going to have to see how that plays out.

Rick Beckwitt: And as I said in my comments, Jon and Stuart and I are making daily adjustments to pricing to make sure that we maintain momentum and those adjustments incorporate what's going on with rents in the single family communities and the investment buyer.

Stephen Kim: Great. Thanks.

Stuart Miller: Next question.

Coordinator: Thank you. Our next question comes from Buck Horne from Raymond James. Please go ahead.

Buck Horne: Hey, good morning. Thanks for the time. I wanted to talk a little bit about the pace of starts that you maintained through the second quarter. It's just - it's interesting that the start pace was still well ahead of the absorption pace even as mortgage rates were consistently rising through the quarter.

Was that a function of the quality of the traffic you were seeing or the buyers that you saw, you know, coming in the front door in terms of their, you know, ability to purchase? Was there some larger thinking in terms of maintaining the start pace at that elevated run rate?

Stuart Miller: You know, I think we've noted before our start pace is primarily a function of an orderly program of building and delivering homes on a recurring basis. Our start pace has been more constrained by the availability of permits and people's ability to actually generate the entitlements and permits that are required in order to start a home. And so you'll see some variability in our starts. As we look ahead to our third quarter, we actually see some modest pull back just because the difficulty in getting permits out.

I've said in my comments, and I'll say again, we've been looking at over the past years a supply - a limited supply of housing across the country. And while the country goes through, you know, the interest rate and sales price kind of reconciliation or rebalancing, we're going to continue an orderly start program. Even as demand moves up and down we'll adjust pricing, in order to get the appropriate amount of deliveries into the system to make up some of the workforce deficiencies that exist in most major markets.

Jon Jaffee: And we've said over the past years that we will match our sales to our start pace versus the other way around to maintain that orderly discipline that Stuart described. We feel that gives us much better control of our cost inputs, and keeps our machine very efficient.

Rick Beckwitt: The other thing that is behind the numbers is that we've been strategically, as we've done in the last several quarters, sold our homes later in the construction cycle, which works very effectively in this market because our buyers want to lock their loan closer to the time that they're going to be closing on the home. And as a result, limited presales or early sales which makes the start pace a little bit higher than the sales pace.

Buck Horne: Got it, very helpful. Thank you for all that. And following up a little bit on the, you know, the kind of the way the pricing adjustment process works as,

you're managing through that, you know, I - it sounds like, you know, as we talk with investors, there's still a lot of concern about potential, you know, land impairment risks with falling prices from here.

But, you know, as you work through this, it sounds like all the pricing that you're still looking at is higher on the year over your basis. Are there instances where your pricing adjustments are reducing base prices below what the backlog customers might have already paid?

Stuart Miller: You know, I think it's important to recognize we have virtually no land impairment risk in our backlog. Our margins remain healthy. We remain focused on recognizing that prices are going to move around a little bit, and we'll continue to build efficiencies in the way that we create value for our customers.

But our land acquisition model and our land acquisition program has been rock solid. And I think the market's going to have to fall awful lot for us to start talking about impairments once again. That's a throw back to the last financial crisis, and we just don't - we have a lot of room in margin. We have a lot of adaptability in our program, long way before we start thinking about impairment.

Jon Jaffee: Also very different from last cycle as mentioned in my comments, our land strategy focus has been on really positioning land on a control position and structures that can adjust to a changing market environment which really gives us further insulation from the potential of impairments.

Rick Beckwitt: And the other thing that we've seen with regard to backlog is to the extent in many markets that someone cancels out, we have a replacement buyer because there's such limited available inventory that's ready to close on.

Buck Horne: That's all very helpful. That's perfectly answered guys. Thanks for the additional color.

Stuart Miller: You bet.

Coordinator: Thank you. Our next question comes from Truman Patterson from Wolfe Research. Please go ahead.

Truman Patterson: Hey, good morning, everyone. Thanks for taking my questions.

Stuart Miller: Morning.

Truman Patterson: Just wanted to follow-up, May incentives where I believe 1.6%. And when I'm thinking through the midpoint of your third quarter orders, guess up kind of 4% to 5% year over year, pretty healthy in the market, I think right now. Just what sort of incentive or pricing adjustments do you think are needed in the upcoming quarter kinda sequentially to hit that metric?

And then also when you're thinking across the three buckets of markets that you mentioned, you know, are there any structural items or reasons that the no impact bucket, you know, might not move closer to the second or third tier?

Jon Jaffe: Of course, Truman I'd say that the analysis that Rick spoke about that Stuart are going to focus on daily is a community by community analysis. So it's - you got to first understand that it's very varied from each community. So even when we speak of a market that's a broad overview, within that market we'll have some communities that are still performing very well, and some that need the assistance with incentives or mortgage rate buydowns that were described.

And as was said, it's very hard to really look forward as there's this rebalancing between pricing interest rates to say exactly what incentive will be needed. And that's why it's a regular focus on a community by community analysis.

Rick Beckwitt: You know, and as I said in my opening remarks, our incentives have just historically run much higher than the 1.6% level. As we look forward, there's probably another point, 1% that has been factored in to our go-forward look with regards to incentives. And as Jon said that that could be 0% in some markets and a little bit higher in others.

Stuart Miller: Yes, but look, I'd even say don't let the 1% be a boundary or a limitation. I think the fact is, you know, you're right now hearing from a group that is looking at these numbers real-time on the market by market basis. And it is changing and evolving in a variety of markets.

The tipping point from a tier one to a tier two to a tier three market as Rick properly describe them, you know, it is a matter of timing, and it's a matter of you know, supply within that market and the confidence level that's embedded in that market -- very hard to anticipate. And you don't really get a warning sign before you see it.

So you're really hearing the - or you're seeing the picture kind of like a balance sheet, the snapshot of where we are today. Tomorrow could move a little bit one way or the other.

Truman Patterson: Yes. Yes I know, I understood. And clearly you all are maintaining elevated absorptions to drive returns.

But next question on, you know, your all shift in your land bank has been, you know, pretty dramatic over the past several years and optioned or controlled lots are now up to 62% this quarter, You know, I'm trying to understand whether there's been any shifts in the land market the past couple months from either your, you know, land developers' or land bank partners', willingness to option deals, change in terms, competition, et cetera, that, you know, by year end, is that kind of 65% metric maybe kind of capped this cycle?

Jon Jaffee: Well, just like for us, this is all happening in real-time. I'm not saying the valuation, you know, happens with our relationships, but to date there's been a willingness to proceed to acquire assets that are properly underwritten.

And I think as we sit here knowing what we know now, we have a good deal confidence that we'll, you know, we get that - hit that 65% target. But like with everything, we have to see how things evolve, you know, where the market goes to.

Stuart Miller: We have a couple of strategies embedded in our land program. First of all, we have some really comprehensive relationships with some of the land developers. I think we moved in sync and everybody understands that sometimes markets move up. We all make money together. Sometimes markets move down, we all shift and adjust to market conditions. I think that's not a difference in the land development world. It's exactly the way that we've constructed our land development world.

Additionally, Jon properly pointed out that our land strategies component of our Quarterra, ultimately, asset management business is a really important structural change for the company. We've built in elasticity in that program, really to be able to act as a shock absorber as we go through the ups and downs of market conditions. And I think it's one of the more important

structural changes that will provide stability for our land programming as we go through the years.

And so this is something that we've been focusing on, anticipating gyrations and movements in the home building world and building land strategies that are flexible for times just like these.

Truman Patterson: Perfect. Thank you for your time.

Coordinator: Thank you. Our next question comes from Alan Ratner from Zelman & Associates. Please go ahead.

Alan Ratner: Hey guys, good morning, thanks for all the detail, appreciate it. You know, first question I guess, you know, really helpful kind of bucketing those markets there in terms of, you know, the ones that you're seeing maybe more of an impact versus others. You know, I'm curious in the bucket with the seven where you have been more aggressive on incentivizing and reducing prices, are you able to quantify what the margin impact from all of those various actions you've taken is on the orders you've placed in June, you know, vis--vis what maybe deliveries were or orders were earlier in the year?

I'm just trying to figure out, you know, you kind of mentioned all the tools you're pulling, but it's hard to tell exactly what the margin impact might be in those various buckets at this point.

Stuart Miller: You know, it's why we've given broad boundaries instead of guidance. We don't want to guess because there are a lot of moving parts -- a lot of them.

You know, the obvious ones like lumber prices and Realtor costs and, you know, variety of things that we can put our finger on, but then there's also

operating leverage and where ASP is going to go and a variety of things, we know that we're trying to aim for a moving target and that target is moving in ways that we can't always anticipate.

So the answer to your question is, we're not quite sure yet. You know, we tried to give some boundaries as to what we see coming up in the third quarter and we're going to address the fourth quarter as we get closer to it and see what that landscape looks like Alan. To get more granular than that would be a series of guesses that I don't think brings any of us closer to something that's actionable.

Alan Ratner: Okay, I appreciate that Stuart. I know it's certainly a moving target here. Second, congrats on the, you know, the land strategy shift and, you know, the execution there getting the option share higher. I guess just from a bigger picture standpoint, when you think about the land market and you think about your land portfolio, you know, your lot count is up about 70% over the last two years. And you know, that growth that's come entirely through option deals, you know, as the owned pieces has shrunk a bit.

Your closings this year are going to be up about 25% over that two year time period. And, you know, you're talking about wanting to maintain a start pace. So even if we kind of assumed that through this choppy period here, you're able to maintain volume, it doesn't seem to me at least that there's, you know, a real reason why you would need 70% more lots under control.

And recognizing a lot of that is off balance sheet, there's still a fair amount of capital tying up that land, you know, which is on your balance sheet. And you know, presumably when you kind of move forward on deciding whether to take down these deals, you know, you're going to have to make that decision.

So how are you thinking about tying up incremental land today? Have you slowed the pace of acquisitions? And does it make sense at this point to maybe walk away from some of those deals if the market at best is maybe more flattish from a volume standpoint for the near term or intermediate term?

Stuart Miller: Look Alan, I think, you know you've been around us and the business for a long time -- land is the most complicated and difficult part of the strategic composition of a home builder. And we have spent, we at Lennar have spent tremendous hours thinking about land strategies and how we can have - how do we create greater visibility to our future without greater risk to our balance sheet?

And that is very much been the balance that we've migrated over these six years. It's what we're most enthusiastic about as it relates to our land strategy's vertical in Quarterra, the ability to tie up more land to give us more visibility, but to do it in ways where we have a maximum flexibility, the ability to, as you say, if the market changes in dramatic fashion, we can pull back or renegotiate or reposition some of the longer dated strategies. The shorter dated strategies are going to be more durable and we'll be able to just build through.

So what we've done is we've trifurcated our thinking around land into short, medium and long term buckets. And we have carefully crafted flexible programs so that we can enhance our visibility and reduce the risk to balance sheet and enhance flexibility in doing so. And I think that's what you're seeing evolve with our company.

You look at our balance today, it is as - it is as strong as it's ever - it's stronger than it's ever been. And the visibility to land only benefits our future.

Alan Ratner: Great. All right, thanks a lot.

Coordinator: Thank you. Our next question comes from Mike Rehaut, from JP Morgan. Please go ahead.

Mike Rehaut: Thanks. Good morning, and thanks for taking my questions. I wanted to just circle back also to the bucketing of the different markets. And appreciate all that detail. It's extremely helpful, wanted to get a sense of in the second and third buckets, you know as a percent of sales perhaps what have those price adjustments been and or if you could talk about it perhaps on a net pricing basis inclusive of incentives? And, you know, is it fair to just anticipate that those adjustments would flow through into the fourth quarter?

Rick Beckwitt: Well as I said in my remarks, you know we're adjusting pricing on a home by home basis. And, you know, in many of these markets, net pricing or gross pricing is up 40% to 50% over the year ago period. So it takes relatively modest price adjustments to move the needle in order to spur some activity in these markets.

You know what buyers are really focused on right now is just sticker shock. There's been an increase in mortgage rates. And that combined with the economic headwinds, people just are concerned, are they making the right decision at this point in time?

The reality is that the markets have very limited inventory. We're seeing rent growth in all of these markets. So folks are really just trying to make sure that they don't feel that when they talk to their neighbor that there's a dumber pool.

So people are working through the process, They understand that values have adjusted. And in the overall mix of what composition of our company as a - on global margin basis, you know, these are very small percentage changes, and what you've seen is us factoring into the go forward guidance.

Jon Jaffee: And just one point of clarification as Rick had mentioned earlier, the combination of, you know, mortgage rate assistance in the form of buydowns, forward commitments, ARMS combined with some price adjustments of the - the mortgage component is a very important component as you deal with as Stuart mentioned earlier, people buy monthly payments.

So we really, you know, in most of the markets in those second two buckets, we don't see much in the way price adjustments versus a combination of mortgage rates help with smaller price adjustment.

Stuart Miller: And I just want to correct my partner Rick and just say dumber fool is a little severe. I think greater fool is a little bit more mild. Go ahead Mike.

Mike Rehaut: Appreciate that. And just for clarity also, some of those mortgage rate, either, you know, adjustments or areas of help, just to be sure I understand that would also flow through the cost of goods sold or impact the gross margin as opposed to the financial services line. Just wanted to make sure we understood that.

But my second question is also kind of shifts to the Quatterra spin by the end of the year. And, you know, just, you know, I guess you said that you would expect \$2.5 billion of assets to come off Lennar's balance sheet. If you could give us any sense of what the total amount of either, you know, any additional detail around Quatterra itself in terms of, you know, total assets under management, you know, and, and obviously you have the different businesses, any type of review or update would be helpful there.

Stuart Miller: So we're not giving regular updates on Quatterra just yet. I don't want to get locked in that bucket, but I think we've given some boundaries in our past

calls as to assets under management relative to Quarterra. I don't want to give you a number right now. I don't have it at my fingertips.

But what I did say is an additional \$2.5 billion over time. I think Jon daylighted some of the migration of some of our land assets through our land strategies program. But we've really seen quite a lot of assets come off our balance sheet already relative to our Quarterra verticals and the way they have developed over the past couple of years.

I think as we move forward, we're going to continue to see our land strategies program really continue to develop. And that will benefit Quarterra. It will also benefit Lennar. But the \$2.5 billion that I've daylighted is additional to the dollars that have already been - that have already migrated from the Lennar balance sheet to the Quarterra, the private equity, components. And Mike, what was the first part of your second question?

Mike Rehaut: Yes, no, it's just the clarification or follow-up to your - the answer to my first question on mortgage buydowns or adjustments...

Stuart Miller: Oh, where do they fit?

Mike Rehaut: ...on those mortgage components, where that flows through on the income statement, if it's the financial services or the regular...

Stuart Miller: Cost of sales.

Mike Rehaut: ...gross margin?

Stuart Miller: Cost of sales, Mike.

Mike Rehaut: Okay, perfect. Thank you so much.

Stuart Miller: Okay. You bet. Why don't we take one more question?

Coordinator: Thank you. Our last question comes from Susan Maklari from Goldman Sachs. Please go ahead.

Stuart Miller: Good morning.

Susan Maklari: Thank you. Good morning, everyone or good afternoon I guess.

Stuart Miller: Afternoon.

Susan Maklari: My first question is, you know, you commented that you have seen some relative improvement in the supply chains, and it feels like we are maybe at or coming off of the peak there. Can you give a bit more color in terms of what you're seeing on that side? And, you know, obviously as the demand does shift and moderate a bit how you're thinking of the further improvement that can come through there?

Jon Jaffe: Well I'll go through the second part of your question. As always there's a lag between any shift in market and a shift in what's going through in terms of construction volume as the construction trades in the supply chain build through the backlog that's under construction.

Relative to what we're seeing as I said in my comments there's still disruptions. But both we and our suppliers are much better positioned today. Everyone has learned a lot over the last two years and are able to respond very quickly to solving problems where at the earlier parts of the pandemic and the

disruptions it sometimes it could take months to solve problems they're now being resolved in days.

And yes the two areas where there's ongoing shortages is really in electrical equipment and in flex duct. But even though we're in close communication with our trade partners that supply that. They've got all the visibility in terms of what our needs are for the coming quarters, and it's a very close working relationship.

Stuart Miller: Is it the resolution of supply chain issues is not so much as the supply chain, you know, has gotten easier it's that we've figured out and worked hard to manage it better. We have the residual impact of the fact that our cycle time still remains a sticky kind of larger version of itself. So it's still taking us longer to produce a home which is inefficient and a derivative of supply chain management.

Susan Maklari: Okay, that's helpful color. My follow-up question is, you know, when you do think about balance sheet and uses of cash in general you noted that you did buy back some stock in the second quarter.

You know, as things do moderate, but you continue to pursue your strategy around land and the spin of Quarterra, all these other efforts that you've been working on, how do you think of uses of cash and especially maybe shareholder returns in a more moderate housing environment?

Stuart Miller: Well, you know, here's the positive thing about what's happened at Lennar is over the past years we've had terrific prosperity. And we've used those moments not to sit back on our laurels but instead to really focus on enhancing our business model.

We've refined the cost of operation, we've focused on cash generation, we've built models that limit inventory and limit the exposure to land on our balance sheet, and it enables us to generate a tremendous amount of cash.

We expect to continue to think very much the same way as we go forward that we're going to be positioning our company with land visibility that enables us to continue to build our business in an orderly fashion. We expect to continue to pay down debt.

We expect to continue to opportunistically buy back stock. And we have the capital on the balance sheet to be able to do that even while we're spending \$2.5 billion of additional capital from Quatterra - so with Quatterra.

So I think that we're in an enviable position of strength. We said so at the end of our press release and in my comments. And that position of strength at times like this is a great way to be positioned and to deal with the market condition. So I think that's a...

Susan Maklari: Great.

Stuart Miller: ...good off-road, a good time to wrap up. Let me say that we as a group, as a management group, are happy to have our partner Rick back in the fold after his bought with COVID last week. He was man down for a few days, but the company was still able to operate without losing a step.

But now we're at full strength, and we look forward to reporting back at the end of third quarter, hopefully with a bit more certainty. Thank you everyone.

Coordinator: That concludes today's conference. Thank you for participating. You may now disconnect your line and, please enjoy the rest of your day.