

LENNAR CORP

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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 call 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 statements.

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 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, recently filed with the SEC. Please note that Lennar assumes no obligation to update any forward-looking statements.

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

Stuart Miller: Very good and thank you. Good morning everyone. This morning I'm here with Rick Beckwitt, Chief Executive Officer and Jon Jaffe, our President and Chief Operating Officer; Diane Bessette, our Chief Financial Officer and of course, David Collins is here; and you just heard from Alex Lumpkin.

So I'm going to start with a general strategic overview. Rick and Jon will give a land and operational overview and Diane will deliver further detail on our third quarter numbers as well as some preliminary guidance for 2019. When we get to Q&A as always I'd like to ask that you limit your questions to just one question and one follow-up, so we can accommodate as many participants.

So let me go ahead and begin by saying that our once again strong quarterly results derived from a seasoned, well-coordinated operating team that is hands on and hitting on all cylinders. With pro forma new orders up approximately 11% year-over-year and pro forma deliveries up 11.4% year-over-year. We are tracking above our own internal targets of 7% to 10% per year growth, even through the integration of the CalAtlantic merger.

As the coordination of systems integration continues and synergies are run from operations, our management team and operating groups are fully engaged and making the adjustments that keep our performance industry leading and consistent.

Over the past quarter, market data -- sorry about that. Little technology issue. So over the past quarter, market data has sent mixed signals about the current state of the housing market in general. Sales, permits, starts and existing

home sales have all shown decelerating growth rate and on their face seemed to indicate slow down.

A natural mortgage application slowdown, which is normal as interest rates have trended higher and refi business dissipates, has contributed to the discourse. Generally speaking, the increases in new and existing sales prices - home sale prices over the past years together with the general migration of interest rates upward have caused a pause in the progression of the housing recovery.

Additionally, labor shortages, trade-driven material price increases and limited approved land availability have both limited production and therefore limited supply and muted sentiment around the housing market strengths and margin sustainability. This has led many to believe that the housing recovery is over or stalled. We do not agree.

Instead, we believe the market has taken a natural pause, it will adjust and demand, driven by fundamental economic strength, will resume. Even as price increases and interest rate movements have moderated demand in the market. We believe that the housing market in the United States remain strong and is primarily driven by the deficit in production that has persisted over a decade.

This production deficit defines an overall housing shortage in the country that cannot correct quickly with a short labor and limited approved land. Supply of dwellings both for sale and for rent is short and demand remain strong though perhaps slower and more normalized in the short-term as the market adjust to prices and interest rates.

While we clearly saw sales slow and traffic moderate during the third quarter, we feel that this is a natural pause, given the relative strength that has been in the market to date. This pause we believe is a temporary adjustment as strong unemployment, wage growth, consumer confidence and economic growth drive the consumer to catch up.

Now, even as market conditions fluctuate, I am increasingly enthusiastic about the evolving position of our business platform with size and market share in the best national markets and as a leader in the home building industry. We're not only well positioned to execute on our current operational strategies, but we have become ever more adaptable and capable of quickly adjusting to changing landscapes around us.

As a management team, we believe that we are excellently structured and positioned to continue to grow our business, while we leverage scale in each of our markets to drive efficiencies and we implement new technologies to enhance bottom-line and free cash flow. Given the current mismatch between our view of market conditions and the investor view displayed in our share price, we continue to believe in our overall strategy of driving earnings and focusing on free cash flow in order to allocate capital to paying down debt and now beginning to actively consider executing an opportunistic stock repurchase.

Before I turn over to Rick and Jon and Diane, let me provide a brief map of our operating and capital allocation strategy going forward. Then our management team will review the quarter in detail and give more guidance on our road ahead.

So let me begin by noting that our debt-to-total cap is right now at 40% at the end of the third quarter versus 42.4% last quarter. Our net debt-to-total cap is

39%. Using a combination of strong earnings and very strong and improving cash flow, we've continued to improve our balance sheet and this affords us great flexibility in the strategy that we deploy going forward.

We have grown and will continue to grow our top line as the market evolves. Through this year and next year, we will continue to grow top line consistent with our land-driven home site growth strategy of 7% to 10% improvement per year.

As we look ahead to 2020, given the extremely tight and expensive land market, we'll begin to tap back that home site growth target, driving our land acquisition program closer to the 5% to 7% range, while we continue to focus on our land soft pivot strategy and decrease the percentage of home sites we purchased out right versus control under option generating higher rates of return and greater cash flow.

While we moderate future home site growth at the top line, we will continue to aggressively grow bottom line by focusing more sharply on operational excellence and efficiency. We will continue to use our size and scale in strategic markets to realize on the synergies from the CalAtlantic merger, drive efficiencies in construction costs and technique and leverage SG&A.

Our focus on operational efficiencies will enable us to maintain consistently high gross margins, while we expand our net operating margin as well. Various elements of our program such as the reduction of debt and debt service and builder of choice initiatives with our building partner base will continue to offset pressures on gross margins.

Additionally, our technology initiatives with Opendoor, Blend, Hippo, States Title, Notarize and others enable us to build a better mousetrap, reduce SG&A

and drive a higher net margin. Strong margins together with a reduced growth rate and focused attention on our soft land pivot combine to generate greater free cash flow.

With cash flow building and our balance sheet already strong and improving, we expect to allocate capital strategically. First to continue to pay down debt but simultaneously to actively consider the repurchase of our stock opportunistically. If the market discounts the value of our business then our best returns on invested capital will be realized by investing in the assets that we know best and we are always driven by what is best for creating shareholder value.

Additionally, as we've discussed in prior calls, we are continuing to drive efficiencies by focusing on our core home building business. This means repositioning or opportunistically monetizing non-core assets and business lines in order to drive efficiency or enhance cash flow.

Lennar's Rialto platform is a good example that we've discussed in prior quarters. As we have noted, we've engaged investment bankers and began a process to maximize value about two quarters ago. To date, we've mapped a constructive reconfiguration of that segment with the Rialto mortgage finance component better situated with Lennar financial services starting December 1st and where efficiencies and synergies can drive even better operating results.

Additionally, the Rialto balance sheet assets are being segregated as well and monetized overtime to maximize their value. This leaves a very manageable asset investment management business defining our remaining Rialto segment.

As part of our process, we've received offers to monetize this business, many of them attractive and we're currently evaluating those offers. But as you know with our company, we will act opportunistically and in the best interest of shareholders. We will sell if the price and the terms negotiated are attractive and otherwise we will retain this segment and drive earnings forward.

As always, over the next quarters, we will keep you updated as decisions are made and will not be fielding further questions during this call on this very active process. Each of our core asset and business segments is being positioned for maximum efficiency and performance.

Our objective, as we stated before is to return to operating as a simplified pure play homebuilder, while maximizing the value and positioning of the extraordinary franchises we've created here at Lennar. So, with that said, in conclusion, with another excellent quarter behind us and a well-defined strategy for the future, we feel very confident that fluctuations in the market will come and go, and even work to our long-term advantage as we execute our strategy.

With that, let me turn over to Rick and the team to get further detail on the quarter and begin our view of 2019. Rick?

Rick Beckwitt: Thanks, Stuart. Let me start quickly by summarizing our results in the third quarter. And then Jon and I will update you on some of our strategic focuses. Net earnings for the quarter totaled \$453 million up 82% from 2017. Our core homebuilding operation really produced, new orders for the quarter totaled 12,319 homes up 62% from the prior year with the dollar value of approximately 5.1 billion representing a 73% increase from last year.

On a pro forma basis, new home orders increased 11% from the prior year. We delivered 12,613 homes, which was up 66% from 2017. Revenues in the quarter totaled \$5.7 billion representing a 74% increase. We ended the third quarter with a sales backlog of 19,220 homes with the dollar value of 8.4 billion up 88% and 105% respectively from 2017.

Our gross margin, excluding the backlog and construction in progress write up totaled 21.9%, which exceeded the top side of our guidance last quarter. Finally, our SG&A in the quarter was 8.6%. This marks an all-time third quarter low, and a 60 basis point improvement from 2017. It also highlights the success of our CalAtlantic integration and the power of our increased local market scale and our operating leverage.

With the CalAtlantic integration behind us, we are laser focused on three strategic areas. First, construction cost and operating efficiencies; second, land acquisition and development; and third, technology that improves our business.

On the construction front, we are leveraging our local market and national scale to be the low cost producer. Jon will review our activities in this area, which also focus on adjustments to how we build and procure materials to lower our overall installed cost.

On the land front, we've continued to execute our soft pivot strategy with an emphasis on controlling more land versus a more cash intensive land acquisition and development program. Today, approximately 25% of our home sites are controlled via option contracts and similar arrangements. And our expectation is to increase this over the next several years to about 40%.

This shift in land strategy will increase our returns and generate additional cash flow. During the third quarter, we entered into strategic agreements with three of our longstanding large regional developers to provide us access to their current land portfolios and exclusive access to the future residential land acquired and developed by these developers.

Given our new leading local market scale and our ability to build through all of the land that these developers own and control, we were able to structure win-win programs with each of these three companies. While each deal is slightly different, they all allow us to, one, limit our land-related overhead costs, as these companies have full operations that entitle, develop and acquire land.

Second, control the residential land entitled, acquired and developed by these regional developers; and third and most importantly, receive the home sites developed by these companies on a just in time basis. Our focus going forward is to align ourselves with proven regional developers that have the infrastructure and expertise to feed Lennar with a continuous stream of finished home sites.

While we're at the early stages of reshaping our land program, these initial three developers provide great opportunity as they own and control approximately 55,000 home sites, with more finished home sites to come as a result of the exclusive relationships and agreements we have with these companies.

In addition, we believe, we can expand and execute this strategy with these developers in other markets and that this program can serve as a template with other proven regional developers across the country. On the technology side

and systems side, we are keenly focused on investing in or developing new technology that improves the operational efficiency of our business.

On prior calls, Stuart has highlighted our investment in Opendoor, and our intense focus on digital marketing, which allows us to reduce our customer acquisition costs. These initiatives have produced both incremental new sales and allowed us to increase our operating margins.

In the third quarter, our realtor spend decreased another 10 basis points to 2.3% of revenue from 2.4% in the second quarter of 2017. On a year-over-year basis, our Rialto basis -- our Rialto spend was down 30 basis points.

In addition, we are also focused on increasing the real time flow of information to our operating teams. Jon has highlighted our dynamic pricing model in the past and we are now rolling out real time dashboards that allow our teams to seamlessly track key operating metrics, which should increase our absorption pace and lower our overall SG&A expenses.

We plan to continue these initiatives, as we're just scratching the surface to unlock the many process improvements that will increase our bottom line profitability going forward.

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

Jon Jaffe: Thanks, Rick. Today, I'm going to give an update on integration, cost synergies, the lumber market, the US Mexico Canadian agreement's impact on lumber as well as an overview of some of the markets in our western area.

First, I want to let you know what we mean when we say we are substantially complete with the integration of CalAtlantic. In all of our divisions and all

communities, we are either set for building out the remaining home sites under a modified design studio program or have converted the remaining communities to Lennar's Everything's Included platform.

Going forward in 2019, all communities will be under the Lennar's Everything's Included platform with the exception of some minor build-outs of our existing communities. With respect to systems migrations, this month in October, we will complete 100% of the conversion of our ERP and construction management systems as well as a complete rollout of sales force lightning as a new company wide CRM platform.

This is another great example of Lennar's execution that we feel is best in class. It's fair to say that most companies will take about two years to rollout just the Salesforce CRM, while in just nine months from the closing date of the merger we will have completed the entire migration and rollout of all systems.

As we complete 2018, we will do so as one company with the merger integration behind us, focused on delivering our fourth quarter and our goals for 2019. Next, I want to confirm that we are on track to deliver the synergies targets we gave you last quarter of \$160 million for 2018. This is split evenly between corporate and SG&A savings and direct construction cost savings. I also want to confirm that we're confident with our prior guidance of achieving synergies of \$380 million in 2019.

For 2019, the overhead savings will be about 115 million of this total. Again, this is consistent with the savings we communicated to you last quarter. On direct construction cost savings, we're on track to deliver about \$265 million of savings from synergies in 2019.

We have a lot of visibility into these savings from the detailed work that comes from the division-by-division, synergy workshops that I've described on prior calls. We've seen the strategy of having significant scale in local markets played out as planned.

As I mentioned in our release this morning, this scale fits right into our focus on being builder of choice for national manufacturers, suppliers and local trades. The builder choice focus began long before the CalAtlantic merger and it's serving as a great platform to maximize the benefits of increased scale provided by the merger.

The key elements of this program are Lennar's efficient Everything's Included platform, even flow production, job site readiness, cycle time accuracy and dynamic pricing. These combined with the volume of work, we have in local markets make us the builder of choice for trade partners, in turn, increasing the number of bids we receive for our work. The increase bids leads to greater ability to manage both construction cost and cycle time.

Now, I want to give some color on what we see with the lumber pricing, which is the largest cost component of our direct cost. Lumber prices peaked in the second quarter of this year, at about \$600 per thousand board feet. This represents about \$7,800 for a typical 2,500 square foot home.

Today, lumber prices have dropped to about \$365 per thousand board feet or \$4,750 per home, a difference of about \$3,000 per home. The second quarter pricing will flow through our third and fourth quarter deliveries and the pricing that we see today will start to flow through our first and second quarter deliveries.

With respect to the new trade agreement with Canada, there will be no relief from the existing soft lumber tariffs from that agreement. Instead, the countries have left this to be decided by the WTO under an existing complaint filed by the United States.

Now, I want to turn to some color on the markets in the West as a lot of questions have been asked about this. As Stuart noted, we've seen traffic and sales patterns slow, as sales prices have risen, along with increased interest rates.

In California markets such as the Inland Empire and Sacramento, our average sales prices increased about 11% year-over-year, while absorption pace in the Inland Empire has moderated from 5.6 sales per community per month last year to five sales per community per month this year.

In Sacramento, we've actually seen this pace increase to positive from a pace last year of 3.2 sales per community per month to 3.8 this year. In the coastal markets around Orange County, prices are up about 20% and absorption has slowed from about 4.7 sales per community per month to 3.1.

Some of this is driven by a dramatic change in mix of product that we offer, for example, in our Altair community in Orange County, we're now selling homes priced about \$2 million in our joint venture community with Toll Brothers.

In the Bay Area, prices are up about 10%, while absorptions have modified from 5.8 per community last year per month to 4.4 this year. In Seattle, prices continue to climb at double-digit rates, while absorptions have cooled from a very hot pace to more normal paces of just below four sales per community per month.

In summary, we believe that the sales pace that we're seeing continues to be advantaged by a favorable imbalance of supply and demand, a constraint on land and labor in the Western markets in particular and that this sales pace will support our platform and all of our operating strategies.

And we think that as Stuart mentioned earlier that this is just a pause because of dramatic rise in the rates that we've seen in the West, not just percentage wise, but in nominal dollars, very often representing multiple hundred thousand dollar increase year-over-year. And we expect as the market adjusts to this increase that we'll see demand return to a very healthy pace.

With that, I'd like to turn it over to Diane.

Dianne Bessette: Thank you, Jon and good morning to everyone. So before, I provide the details of our third quarter results. Let me give a simple analysis of our numbers as compared to consensus, as I did last quarter, to assist in understanding some of the noise that continued this quarter.

Our reported EPS is \$1.37 and the average of all analyst estimates is \$1.17. The difference is \$0.20. This difference of \$0.20 can be separated into two categories. First, non-operating items, representing \$0.14 of the difference; and second, operating items, representing \$0.06 of the difference. The \$0.06 is our operating beat or our outperformance, as you compare our actual results to expectations.

So let me give you the details of these two categories, starting with the non-operating items. There are two distinct components to this category. The first item is the CalAtlantic purchase accounting write-up of backlog and construction in progress.

The expectation for Q3 was to record approximately \$100 million of write-up. The actual amount recorded was approximately \$84 million. The difference between these two amounts is just timing and will flow through in subsequent quarters.

The second item is tax rate. Our expected Q3 tax rate was 24%. The actual tax rate was 17.8%. The difference primarily relates to a one-time benefit from a tax accounting method change, implemented during the quarter and energy credits taken in the quarter.

So now, let me turn to the operating items category. The difference here between our actual results and expectations relates to an increase in Q3 deliveries, average sales price and net margins. And as I previously stated, again, that's our operating outperformance.

So hopefully that helps simplify our results from a top level. Now, let me walk through the details of our third quarter, starting with homebuilding. As we've mentioned, revenues from home sales increased 83% in the third quarter, driven by a 66% increase in wholly owned deliveries to 12,600 and a 10% increase in average sales price to 415,000.

Both of these increases of course were primarily results of CalAtlantic acquisition and as we've highlighted from a pro forma basis, our deliveries increased 11%. Our third quarter gross margin on home sales was 21.9%, excluding the CalAtlantic purchase accounting impact and the prior year's gross margin of 22.8% which included a \$10.3 million insurance recovery that positively impacted the gross margin percentage by 30 basis points in that third quarter of '17.

Our gross margin benefited from a decrease in sales incentives. Sales incentives improved 30 basis points to 5.2% from 5.5% in the prior year and also improved from 5.3% in the second quarter of this year.

Our third quarter SG&A was 8.6%, which as Rick highlighted was the lowest third quarter SG&A in the company's history, compared to 9.2% in the prior year. The improvement was primarily due to the operating leverage as well as our continued laser focus on obtaining benefits from our technology initiatives.

We opened 134 new communities during the quarter and closed 147 communities to end the quarter with 1,312 active communities. New home orders increased 62% and new order dollar value increased 73% for the third quarter. Again, primarily as a result of the CalAtlantic acquisition and new orders on a pro forma basis increased 11%.

As a result of our focus on inventory management and with the assistance of our dynamic pricing tool, we ended the quarter with 1,248 completed, unsold homes, which is just under one home per community. This is a decrease from 1.2 homes per community in the prior year and 1.1 homes per community in the prior quarter.

At the end of the quarter, our home sites owned and controlled were 262,000, of which 205,000 are owned and 57,000 are controlled. And finally, the third quarter joint venture land sales and other category had a combined earnings of \$800,000 compared to a loss last year of \$1.7 million.

So turning to financial services, our financial services segment had operating earnings of \$56.6 million compared to \$49.1 million in the prior year.

Mortgage operating earnings increased to \$33.8 million from \$32.5 million in the prior year.

Originations increased to \$3 billion from \$2.2 billion. And 97% of originations were from purchased business, while only 3% were from refis. As we've noted for a while, this drop in refis has led to a very competitive market and is leading to lower profit per loan originated.

Our capture rate was 71%, combined Lennar and CalAtlantic versus 80% in the prior year, Lennar only. Historically, CalAtlantic's capture rate was lower than Lennar's, so we should see continued improvement in our combined rate, as we capture more of that business.

Title operating earnings increased to \$22.1 million from \$15.6 million in the prior year. The increase again of course was due to the addition of CalAtlantic closings and a higher mix of purchase business with higher transaction values versus the prior year.

In the third quarter, our multifamily segment had an operating loss of \$3.9 million compared to operating earnings of \$9.1 million in the prior year. In the current quarter, we recorded \$1.7 million of equity and earnings from the sale of one operating property as well as \$5.1 million of promote revenue related to two properties in our LMV fund.

In the prior year, we had \$15.4 million of equity and earnings from sale of two operating properties and no promote revenue was recorded. As we've noted for a while, we have been moving from a built to sell to a built to hold platform, earning fees and promotes, while creating value within our fund.

We ended the quarter with 22 completed and operating properties and 28 under construction, four of which are in lease up, totaling approximately 14,800 apartments with a total development cost of approximately \$4.9 billion. Including these communities, we have a total diversified development pipeline of over \$10 billion and over 26,000 apartments.

And then turning to Rialto, our Rialto segment had operating earnings of \$10.7 million compared to \$3.2 million in the prior year and both of those amounts are net of non-controlling interests. The details of the segment businesses are as follows.

The investment management business contributed \$31.4 million of earnings, primarily driven by \$19.8 million of management fees. Rialto mortgage finance business contributed \$517 million of commercial loans into six securitizations, resulting in earnings of \$9.2 million before their G&A.

The team continues to perform exceedingly well in a highly competitive commercial loan market. Direct investments had a loss of \$7 million, as we continue to work through the remaining assets from the bank portfolios and G&A expenses were \$23 million.

Turning to our balance sheet, we ended the quarter with \$833 million of cash. During the quarter, we had continued success with our focus on deleveraging. We repaid \$250 million of 6.95% senior notes, using available cash, not refinanced and reduced the borrowings on our revolving credit facility by \$300 million.

And as Stuart mentioned, at quarter end, our homebuilding debt to total cap was 40.1% and 37.9% on a net basis. Stockholders' equity increased to \$14 billion and our book of value per share grew \$42.48 per share.

And lastly, during the quarter, we were pleased to achieve an upgrade from Fitch to investment grade. And then turning to our guidance for the fourth quarter, starting with home building, we are adjusting both our deliveries and new order guidance, primarily to reflect the impact of Hurricane Florence and also to reflect the sluggishness that we are currently seeing in the market.

We are adjusting our Q4 delivery guidance to 14,500 and adjusting our Q4 new order guidance to 11,400. We expect our ending community count to be approximately 1,330. We expect our Q4 average sales price to be about \$420,000.

We are maintaining our Q4 gross margin guidance of 22.5% to 22.75%, excluding the write-up of backlog and construction in progress. And we still expect to record about 50 million in Q4 related to turn of that write-up of backlog and construction in progress.

We believe our Q4 SG&A percent will be approximately 8 to 8.1% and for the combined category of joint ventures, land sales and other income, we expect Q4 earnings to be about \$20 million. We are adjusting our Q4 earnings for financial services to about \$57 million, which also reflects the change in deliveries, as noted above.

And for multifamily, we're maintaining our Q4 guidance of approximately \$35 million. And for Rialto, we expect Q4 earnings to be about \$5 million, which is a decrease from previous guidance. We have shifted a sale of a strategic balance sheet investment from Q4 to 2019 because the investment has continued to appreciate and we therefore believe that a 2019 monetization will result in a higher return.

We expect Q4 corporate G&A to be about 1.5% of total revenues and we believe we will still have a small amount of continuing integration costs of about \$15 million. Our tax rate is expected to be about 24% and the weighted average share count should be about 330 million shares.

So as you put the components of our guidance together, we believe our Q4 EPS, excluding the write-up of backlog and construction in progress and integration costs, should be approximately \$2.06. This is a slight decrease from the range previously provided, as mentioned, due to the impact of Hurricane Florence, and to reflect a bit of sluggishness in today's markets.

Finally, you might remember that when we announced the CalAtlantic acquisition, we noted that we would provide preliminary guidance for our core homebuilding business for fiscal 2019 on this call. So, as we think about deliveries, we expect to deliver approximately 53,000 homes in fiscal 2019.

This would be an increase of about 15% from forecasted deliveries in 2018 and an 8% increase in pro forma deliveries for 2018. This is consistent with our previously stated strategic growth range of 7% to 10%. We believe our gross margins will be in the range of 21.75% to 22%, as we continue to move in the direction of optioning more land and producing higher returns.

We expect our SG&A to be about 8.4%, as we continue to drive efficiencies in our operations. So in conclusion, with those goals in mind, we're well positioned to deliver another strong and profitable year in '18 and look forward to a great 2019.

And now, I'll turn it back to the operator for questions.

Coordinator: Thank you. We'll begin the question-and-answer session. To ask a question please press star followed by the number 1. Please unmute your phone and record your name clearly when prompted. One question with one follow-up for participants in the line. One moment please for the first question.

And we have a question coming from Stephen Kim from Evercore ISI.

Stuart Miller: Good morning.

Coordinator: Stephen Kim, we have an open line.

Stephen Kim: Yes. Thank you very much. Can you hear me.

Stuart Miller: Yep.

Stephen Kim: Okay. Sorry about that. Thanks for all the commentary and the guidance and good job on the quarter. I do want to ask you a little bit about the land agreements you have struck with the three regional developers. You mentioned, I'm trying to get a sense for what is really different between what you've done here versus what you, you know, have done on an ongoing basis in your history.

You indicated those exclusive assets, I guess with a 55,000 home sites, but you didn't mention anything about the terms as far as I heard and I was curious if you've, you know, given any guarantees. If you could talk a little bit about what the timing of the cash flows might be in terms of, you know, the amount of deposit you put down and other things like that that might be relevant to helping us frame how these arrangements might be a bit different from what you've done in the past.

Rick Beckwitt: So Steve, it's Rick. At this point, we're not going to get into a lot of the details associated with those agreements because they're confidential at this point. And, you know, but I can tell you there are no guarantees. These are very strategic, well-crafted structures that really guarantee us pipeline that these guys developed.

And, you know, I can't go into a lot of the details at this point. As we move forward, we'll give you a little bit more color as to what the structures of the deals are. But it's confidential at this point and, you know, for competitive reasons I don't want to get into it.

Stuart Miller: You know, but the two things I would note Steve are, this is the beginnings of the reflection of using size and scale in local markets to be able to comfortably absorb what some of the better developers are bringing in their pipeline to market, and it is also reflective of our, the continuation of our soft pivot to migrate towards fewer home sites purchased for longer period of times on book and using strength and relationship with proven actors in the land market to have more of a just-in-time delivery system for home sites with a greater focus on returns on assets.

Jon Jaffe: Steve, this is Jon. One other thought on this and I've talked about it, it's really another reflection of our position, where we have dominant market share of being the builder of choice for land developers. So they know and they've discussed with us that we're going to be the dominant buyer of their land and so it's getting ahead of that and figuring out a structure that allows us to control what they'll be delivering in the future, for them to know that their pipeline will be absorbed by us in a structure that creates a true win-win situation along the lines of what Stuart and Rick described.

Stephen Kim: Yeah. Sure. It absolutely makes sense. Well, great, well, we look forward to getting more info on that as it comes. I guess my second question related to the guidance you gave and in particular, Diane, I think, you had mentioned a gross margin number, 21.75% to 22%. And earlier, Jon had mentioned about, I think, 70 basis point benefit roughly, given the \$3000 benefit in the first and second quarters from lumber.

I was curious to what degree your guidance of 21.75% to 22% incorporates an assumption that the lumber prices remain where they are for the remainder of next year, if you could give us some sense of what kind of lumber contribution is embedded in that guidance?

And also, if there is -- I was a little surprised that you mentioned that the option strategy was going to be manifested in the gross margin next year. I was a little surprised that it would happen that quickly, so maybe if you could just kind of elaborate on why the -- why you called that one out as a driver to the gross margin being a little lower than it otherwise would've been.

Stuart Miller: Let me start here, Steve. I think Rick wants to chime in after, but let me just say that, one of the -- we've not generally given guidance for the next year until the fourth quarter. So one of the problems with getting out a little bit further ahead and we do want to give guidance and give some direction, as the combination has brought some increased question or discussion around where we're going.

But those numbers are moving around a little bit, so you very accurately highlight the flow through of the lumber numbers and how a migration towards more options might flow through those numbers. Right now, it's an imperfect calculation and so we'll refine those numbers as we go forward, but directionally, we wanted to give you a fairly decent understanding of where

we see ourselves headed, given current market conditions and given a best assessment of what we see for the next year. Rick?

Rick Beckwitt: Yeah. And I guess in addition to that, the soft pivot strategy has been going on for several quarters now. We have -- we mentioned on prior calls that as we utilize more third party retail option type structures that the gross margin associated with that is a much lower margin, but a higher IRR. So, you're starting to see some of that kick in, in 2019. In addition, the deals that I outlined included with them, immediate position in the portfolio that these guys are developing.

So it's not that's just the future deals, it's their current pipeline. So that's why we've put in about 25 bps of margin differential from where we were prior.

Stephen Kim: Got it, excellent. Thanks very much guys.

Coordinator: Thank you. We have a question coming from Michael Rehaut from JPMorgan.

Michael Rehaut: Good morning, thank you. First question, I just wanted to get a sense a little bit, your comments around some of the slowdown that occurred during the quarter, as you looked at your order trends. I don't know if there's an ability to kind of give us a sense of the organic growth, how that tracked throughout the quarter, if there's a sense of month to month of the 11%, was it stronger in the first month or two and below that rate in the last month.

And also, if I just heard correctly that you expect the orders for 4Q to be 11,400. I think that was only a 200 unit decrease, which seems relatively mild.

Rick Beckwitt: So let's just talk about the quarter. I think we saw a sequential improvement month to month throughout the quarter. And when you're talking about whether it's organic or not organic, we're comparing to pro forma numbers. So organic -- it was all organic.

With regard to the Q4 lowering of a couple of hundred homes -- new order on the home side, that's a contribution of some homes having slipped because of the storm, the hurricane into Q4 that we lost in Q3, but also some delay associated with the storm going forward. So it's, I think, what we feel relatively positive about the market, as Stuart and Jon said, the market has paused a little bit, but we're seeing good, consistent, normalized demand.

Jon Jaffe: If you think about Michael, in some of the markets, as I articulated, when you're at a pace above five sales per community per month, that's really not sustainable. You're going to run into resistance at some point and where it has shifted to is a very normal rate. In some cases, above that level four, that one a week that we sort of strive for as ideal in many of our markets. So, there is -- on a relative basis, right, a slowing, but when you step back and look at it, it's a very healthy, sustainable rate that we're at right now.

Michael Rehaut: No, no. I appreciate that Jon. I guess secondly, and I realize, Stuart, as you said, it's kind of an early number and probably you will be sharpening the pencil perhaps over the next three months ahead of your 4Q call. But I think a lot of people will be focusing, as Steve before was asking around the 2019 gross margin number. And I think it was helpful, I believe, Rick that you mentioned that perhaps the higher level of optioning might be a 25 bps headwind.

You also have an expected roughly 100 bps tailwind from increased synergies, that roughly \$220 million as well as some tailwind from lumber. So the

offsetting headwind I guess is what I'm trying to get my head around, when you think about the fact that 2018 will be 22% or a little bit below 22% gross margin ex purchase accounting if I have that math right. Where is the other offset? Is it mix? Is it higher priced land coming through? The difference more perhaps, either -- again mix being either geographic or demographic, any help there would be helpful?

Jon Jaffe: Michael, it's Jon. Relative to gross margin, mix is not the major driver there, but we do see that we're in an environment where it's constrained relative to land and labor. So, you do have year-over-year flowing through higher land costs and higher direct construction costs. So with Lennar, you have a story of what's happened in the marketplace relative to that constraint, offset by synergy savings to marketplace benefit of what's happening with lumber that will show up in the first half of next year.

So you have, as you know, both headwinds and tailwinds. So on balance as we forecast a long time ago, we felt that post-merger would be around 22% gross margins with the benefit of the synergies. And so I think you see all of those components, both headwinds and tailwinds reflecting in that preliminary guidance that we gave.

Michael Rehaut: Great, thank you.

Coordinator: Thank you. Our next question is from Scott Schrier of Citi. You have an open line.

Scott Schrier: Hi, good morning, thanks for taking my questions. I appreciate all the color that you gave earlier in the call regarding California. I'm just curious if I can dig a little bit deeper into it, obviously, your ASP growth there was exceptional. Can you speak to the role that mix had there? And then if you're

talking about how you had this temporary slowdown, you had absorption slow, is some of the reason there behind tax and if so, when you expect this to pick up again?

Do you expect to pick it up again, do you expect to absorptions pick up again at the expense of ASP growth or do you look at this as sustainable?

Stuart Miller: There's not a one size fits all answer to that. In some cases, the ASP change is mix, as I tried to highlight in that Orange County example. And in many -- most cases, it's really just price appreciation in local markets, market like Seattle that's been driven by tremendous job growth. You just had year-over-year price acceleration, in the Bay Area, with the boom in the tech world, you've seen year-over-year price appreciation. So, you have both things going on, but more price appreciation than mix.

As far as being able to look forward and predict when we'll see pace increase, that's very hard to do. What we see is we see demand, we see people with lot of interest, we see people pausing as we all have said and just not having the urgency to buy now. So we don't want to suggest that people have left the marketplace or have lost an interest in purchasing. It's more that they're stepping back and as we've seen in past market cycles, adjusting to new pricing, which results in a higher monthly mortgage payment. And if people adjust to that, we expect that they'll come back in to the marketplace.

Stuart Miller: Yeah. Embedded in your question, you asked about the tax effect and I think that as we look at the market right now and take its temperature, I think that we would say that you're seeing more impact from just price and interest rate migration and adjustment to where the market has gone than any discernible connection between a lack of demand or change in demand pattern, relative to

where tax rates have moved and any impact in California, we just haven't seen that yet, not in our price ranges.

Scott Schrier: Got it. Thanks for that, that's helpful. And just for my follow up, I'd like to round out that discussion on some of your other main areas, if you could just talk about absorption trends, directionally in areas like Texas and Florida that would be great.

Rick Beckwitt: So, if you look at our other major markets, which are really Texas and Florida, I would tell you that we had strong performance in those markets. Texas was up significantly year-over-year, almost 20% in new orders as a whole state. We look at Florida, the Florida markets continue to be robust. That said, there are, in the Dallas market, at the higher end of the price points that market has gotten a little bit softer, but really across the board, it's your sub \$300,000 in price point, it's a very strong market.

And we saw continued strength in Florida, so you know pretty much across the board, other than on the West Coast, where there was a little bit of softness, as prices have increased dramatically, we feel that we're in a relatively normalized market right now.

Scott Schrier: Great thank you.

Coordinator: Thank you. And our next question is from Stephen East of Wells Fargo. You have an open line.

Paul Przybylski: Actually, this is Paul Przybylski on for Stephen. Considering the new demand environment, is your focus more on orders or margin and as kind of have this pause, do you think the industry is maybe protecting that backlog right now

and the softness continued until the fourth quarter that we may actually see industry move to even higher incentives?

Rick Beckwitt: Well, as you saw during the quarter, we really didn't increase the incentives for Q3. We're very focused on converting our backlog into revenue. As we do, we're focused every quarter and as we run the business, as we talk about in the past, we are constantly balancing sales pace and margin through our dynamic pricing models that Jon has really led for the company.

Jon Jaffe: Yeah. As we've talked before, it's really a market by market, community by community analysis, relative to price and pace and we make that decision very, very locally. And with respect to backlog, we're not talking about a market shift that would cause us or any other builder, I think, to be concerned about their backlog. What we're talking about is just a market that has, on a relative basis, shifted from very strong to more normalized paced in the cases that we're talking about.

Stuart Miller: Let me circle back to something that I highlighted in my comments, because I think it is kind of a direct answer to the question, which is our view is that the market has kind of reacted to price and rates having moved fairly dramatically over the past quarters and years. But we go back and we constantly look at the production pace that we've seen over the past years.

The constraint of land and labor that is well documented, that has narrowed the funnel through which supply shortage could be addressed and can be addressed and we look at the normalized demand level for the country and though some might argue that 1.5 million isn't the same as it used to be, we've been producing at a significantly lower level for the better part of the past decade.

So we've been building pent up demand. I think our view and I think generally the industry view is that embedded in these numbers, there is a demand pattern and basic economic strength underlying it that will help correct and drive the market forward. So I would say, pretty aggressively that we're not protecting backlog and certainly nothing reflective of what we've seen in past cycles.

Instead, I think there's a pause. I think, there's a catch up and I think that we'll, with economic drivers driving forward, see a resumption of or a normalization of the patterns going forward.

Paul Przybylski: Thank you. And just as a follow-up on the integration or synergy savings, you're referring that? Are there any risks or upside potential you see moving forward?

Jon Jaffe: We feel, as I said, pretty comfortable. We have a lot of clarity to the synergies that we've identified. There's a lot of work to do to realize them, but we've seen that come into place relative to 2018 as we're in our last quarter of 2018, we feel that those are very much locked and loaded agreements are in place with national vendors that will carry it through the full year of 2019.

So, I don't see a lot of risk. Is there upside? There's always the potential for upside, as we dig deeper into it and one synergy builds on the next, but for us, the focus is the day-to-day blocking and tackling of executing on what we've identified and making sure that we deliver on that.

Paul Przybylski: Thank you.

Coordinator: And we have a question from Alan Ratner of Zelman and Associates. You have an open line.

Stuart Miller: Okay. And we'll make this the last question. Go ahead, Alan.

Alan Ratner: Thanks for squeezing me in here and nice job, given the choppy environment of late. I think, taking a step back, if mid to high single digit growth is as bad as it's going to get, it's certainly not draconian view that the market seems to be expressing right now. But, just as far as what you're seeing as far as the deceleration, is there any notable differences you're seeing across the various price points you build out?

I know, you gave the geographic exposure, but any main differences you're seeing across your buyer pools and does that impact how you're thinking about land investment today as far as maybe shifting the portfolio subtly over the next couple of years.

Rick Beckwitt: Well, sort of on a general basis and there are some exceptions. At the higher price points, it's gotten a little bit softer than the lower price points had been. And that's not unusual in a market that there's a lot of publicity as to what's going on in mortgage rates and price appreciation, because the more affluent buyer time their purchase based on where they think the world is going.

And so, we think, as we said consistently that this is just a market adjustment to a more normalized market from what was really a red hot market in some of these markets. With regard to land and our land strategy, we have consistently said for the last year that we've been shifting a lot of our land investment to the entry level and that first time move up buyer, because it's the fat of the market and our teams have been focused on making investments in that area.

Alan Ratner: Got it, that's very helpful, Rick. And then, I think on the capital allocation side, you mention share repurchase activity potential, which I think makes a lot of sense at the current levels. One thing I don't think you mentioned was the possibility of more M&A and I know while it's no fun to see stock prices go down, you guys have historically been very opportunistic on the M&A front during periods of disruption in the equity markets.

So, just kind of curious how you're thinking about the possibility of doing another deal, now that the CalAtlantic integration is behind you and are there any interesting opportunities, either public or private, starting to pop up now, given some of the pullback in the share prices.

Stuart Miller: Well, Alan, as you can imagine, we probably won't comment too deeply on the answer to that question, but you know us. Number one, everything is on the table and from our company's perspective, we love a bargain, we're very opportunistic and always have been, we're always focused on competing alternatives. We are -- we have highlighted that we've been very cash flow focused. We've really positioned our balance sheet very well.

Diane's done a great job of managing our capital allocation and programming to date. We sit with an excellent balance sheet in just a short time after completing a transaction and integration complete, it really positions us to look at organic growth, at M&A, should there be unique opportunities, but everything measured against the most obvious bargain, which is the group of assets that we know best, the group of assets that we control, the least form of friction and that is buying back stock.

So as we sit here today, and we look at the capital markets, not enamored with the home building sector, as we look at the landscape with the growth rates as we see them today and the production deficit as we see that -- as we see it

today and as tomorrow we have our board meeting and we sit and talk to our board for advice, very much on the table is the question of allocating capital in balance between paying down debt and buying back stock as against some of those other alternatives.

So never think for a minute that anything is off the table with Lennar. We love a good bargain and this is an environment where you start to find them.

Alan Ratner: Great, thank you guys, thanks a lot.

Stuart Miller: Okay. So with that, we'll wrap up. Thanks for joining us and we look forward to updating again for our fourth quarter and into 2019. Thank you everyone.

Coordinator: Thank you and that concludes today's conference. Thank you all for participating. You may now disconnect.

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