

**LENNAR CORP**

**January 9, 2019  
11:00 am EST**

Coordinator: Welcome to Lennar's Fourth Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. After the presentation, we will conduct a question-and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time. I will now turn the call over to 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 condition, results of operations, cash flows, strategies and prospects. Forward-looking statements represent only Lennar's estimates on the date of this conference call and are not intended to give any assurance as to actual future results. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties.

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

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

Coordinator: Thank you.

I would like to introduce your host, Mr. Stuart Miller, Executive Chairman.

Sir, you may now begin.

Stuart Miller: Great. Thank you. And thank you Alex. And this morning I'm here with Rick Beckwitt, our Chief Executive Officer; Jon Jaffe, our President and Chief Operating Officer; Diane Bessette, our Chief Financial Officer; Jeff McCall, our Senior Vice President, and of course, David Collins, our Controller.

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 fourth quarter numbers, as well as some preliminary guidance on our first quarter of 2019. As noted in our press release, we will forgo further detailed guidance at this time. As always, when we get to Q&A, we'd like to ask that you limit your questions to just one question and one follow-up so we can accommodate as many as possible.

So let me go ahead and begin by saying that given the slower housing market conditions we continued to see in the fourth quarter, we're very pleased to report strong results. With sales and deliveries at - or while sales and deliveries were somewhat off-target in the quarter, our bottom line and cash generation were strong and we continue to execute on our long-term strategy of selling noncore assets, strengthening our balance sheet and focusing on our core homebuilding business.

Overall, the housing market continued to slow through the fourth quarter of 2018 as higher home prices and rapid interest rate increases combined to create a mismatch between prices and buyer expectations. As we entered the seasonally slower fourth quarter, purchasers remained on the sidelines awaiting the market to adjust. Sales rates were slower than expected and increased incentives were needed to adjust pricing to entice a reticent market to transact.

Over the past quarter, market data has clearly indicated that the housing market and recovery has decelerated and seems to indicate a continued slower market ahead. Generally speaking, the increases in new and existing home prices over the past years, together with the rapid increase in interest rates, have caused a pause in the housing market and precipitated some price compression. Additionally, labor shortages, trade-driven material price increases and limited approved land availability have maintained upward pressure on cost. With recent

pressure on both volume and margin, many have become concerned that the housing market has completely stalled.

We still do not agree.

As rates have started to ease, we have seen traffic pickup. Therefore, we continue to believe the market has taken a natural pause. It will adjust and recalibrate and demand, driven by fundamental economic strength, will resume.

We still believe that the housing market is primarily driven by the deficit in housing production that has persisted for over a decade. This production deficit defines an overall housing shortage in the country. Supply of dwellings, both for sale and for rent, continued to be short and underlying demand remained strong, though perhaps short - lower in the short term as the market adjusts to prices and interest rates.

While we clearly saw traffic moderate and sales slow during the fourth quarter, with inventories low, we believe this is a temporary adjustment as strong employment, wage growth, consumer confidence and economic growth drive the consumer to catch up.

Against that backdrop, Lennar has continued to perform very well. While pro forma sales were lower by 2% year-over-year, deliveries were up by 17.3% and we achieved net earnings of almost \$800 million this quarter. These results enabled us to repay \$275 million in senior notes, opportunistically repurchase \$250 million of stock and end up with a debt-to-total capital ratio of 36.9%, which is an 800-basis-point improvement over last year before we purchased CalAtlantic. We expect to continue to generate strong cash flow over 2019 and expect to use cash to pay down - both to pay down debt while continuing to opportunistically repurchase stock.

Additionally, we are focused on reverting to our core homebuilding platform by repositioning, opportunistically monetizing noncore assets and business lines in order to drive efficiencies and enhance cash flow. This enables our management team to strengthen their focus on our core homebuilding business. Let me briefly walk through some examples.

As noted in our press release, we sold and closed our Rialto Investment and Asset Management platform for \$340 million in the fourth quarter. While we continue to hold valuable passive investment assets, we will no longer oversee nor be engaged in the active management of Rialto.

Next, we contracted to sell our real estate brokerage business, which closed for cash and a small profit in the first quarter of 2019. Lennar's management team, again, will no longer be engaged in the running of that business as well.

Also in the fourth quarter, we contracted for and closed in the early part of the first quarter the sale of the majority of our North American Title Group to a technology title company named States Title. In this transaction, States Title acquired for cash, debt and ownership in States Title, nearly all of our retail title agency business, as well as our wholly owned title insurance carrier. Lennar has retained the title insurance agency business that services our core homebuilding operation.

With this transaction, we opportunistically monetize a key noncore asset. We executed on our strategy of investing in transformational technology teams and platforms in our industry. We allowed a truly innovative industry newcomer to gain national scale overnight so they can build on that platform to dramatically change their market. And we turned oversight of that operating platform over to States Title who is a best-in-class technology partner.

We've also strategically invested in the home insurance platform named Hippo. Hippo is building the leading technology-based, direct-to-consumer home owners insurance company by creating a very efficient purchase process and delivering modern coverage with an ongoing and proactive approach to insurance. Lennar is partnering with Hippo to not only create the easiest possible insurance onboarding and purchase flow, but is also focusing on providing its customers with modern and extensive coverage.

As with States Title, we're exiting the oversight of that noncore business and investing with and aligning ourselves with technology innovators and best-of-breed service providers at the forefront of creating a modern experience for our customers. We have emphasized before that we're very serious about investing in technologies and technology teams that can change our industry and enhance our company's execution. Now that strategy is facilitating our

reversion to core strategy, enabling us to reduce overhead while we focus on our core homebuilding business and partner with best-of-breed technology partners to create a new and exciting customer experience for our homebuyers.

Putting this together, and very simply, our reversion to core and technology investment strategies have combined to enable us to rationalize our overall business, recognize significant cash flow and profits, improve our customers' experience, while reducing headcount under our management by now approximately 2,000 associates to date. This strategy will continue to reduce company overhead and increase efficiency in our core operations. We're continuing to build a better mousetrap.

Before I turn over to Rick, Jon and Diane, let me say - let me just say that even with the softness in current market conditions, we are very excited about our position and our business strategy today. We truly transformed our company. We benefit from the size and scale we've amassed in each of our strategic markets. We are generating strong cash flow and bottom-line profitability. Our balance sheet is strengthening while we use the weakness of market to opportunistically repurchase shares. We are shedding noncore assets to generate cash and to partner with tech companies who can help enhance our customers' experience while reducing overheads.

While there is uncertainty in the homebuilding market today and we will forego detailed full-year guidance until the selling season brings additional clarity, we're extremely well-positioned to manage market conditions as they present themselves. Based on our existing land position and our operational strategy and our dynamic pricing model, we fully expect to deliver over 50,000 homes this year with increased efficiency, strong bottom line profitability and continued strong cash flow.

With that, let me turn over to the rest of the team to give further detail on the quarter and year end.

Richard Beckwitt: Thanks, Stuart. This is Rick.

In spite of somewhat softer market conditions, we achieved strong top and bottom line growth in the fourth quarter, driven by the successful integration of CalAtlantic. Revenues

for the quarter totaled \$6.5 billion, representing a 71% increase from 2017. This was largely driven by a 64% increase in deliveries to 14,154 homes.

Our gross margins, excluding backlog and construction in process write-up totaled 22.1%. This was slightly below our prior guidance as we chose to aggressively sell completed inventory and price to market as the market softened in the quarter.

Our SG&A in the quarter was 7.9%. This marks an all-time quarterly low and a 50-basis-point improvement from 2017. It also highlights the power of our increased local market scale and our operating leverage.

Net earnings through the quarter totaled \$796 million, up 157% from 2017. Excluding the gain on the sale of Rialto, net earnings totaled \$568 million, up 83% from 2017. New orders through the quarter totaled 10,611 homes, up 44% from the prior year with a dollar value of approximately \$4.2 billion, representing a 49% increase.

On a pro forma basis, new home orders decreased 2% from the prior year. In the quarter, the combination of higher sales prices and mortgage rates moderated demand, leading to reduced traffic, slower absorptions and increased incentives. Our sales pace per community dropped sequentially and year-over-year from 3.1 to 2.7. Sales incentives increased sequentially from 5.2% to 5.6%, but remained lower than our fourth quarter in 2017.

In December of 2019, our fiscal year, we did see an increase in qualified traffic and were able to reduce our sales incentives. While it's too soon to tell, we are optimistic that improved consumer confidence and wage growth, combined with lower mortgage rates, will spur increased activity as we move into the spring selling season.

We ended the fourth quarter with a sales backlog of 15,616 homes with a total dollar value of \$6.6 billion, which was up 75% and 85%, respectively from 2017.

As I said earlier in the fourth quarter, we strategically closed and sold a lot of completed inventory at market prices to generate cash flow and to avoid a buildup in inventory in the current soft market environment. In addition, a large percentage of our sales during the

quarter, due to our dynamic pricing model that Jon will discuss further, were sales earlier in the construction process.

The combined impact of this strategy leaves us positioned with a historically low beginning first quarter completed unsold inventory and a backlog with a significant concentration of early-stage sales. Based on this, our first quarter 2019 deliveries should be in the range of 9,000 to 9,500 homes. As we look out over the year, given our existing land positions and our production-orientated operating strategy, we comfortably expect to deliver over 50,000 homes in fiscal 2019.

As I mentioned last quarter, we are laser focused on cash flow generation to reduce debt and to opportunistically repurchase shares. To further enhance our cash flow generation, we are continuing our pivot to a land-lighter operating model with an emphasis on controlling more land versus a more cash-intensive land acquisition and development program.

We ended the year with approximately 25% of our homesites controlled via option contracts and similar arrangements. And our goal is to increase this to over 40% in the next several years. This shift in land strategy will increase our returns on inventory and generate additional cash flow.

As I mentioned last quarter, we entered into strategic agreements with three of our long-standing regional developers in the southeast to provide us access to their current land portfolios and exclusive access to the future residential land acquired and developed by these developers. While the three deals are slightly different, in each one we made a strategic investment to achieve the following five attributes: one, limit our land-related overhead costs; two, capitalize on the proven expertise, infrastructure, local market knowledge and deep relationship of the management teams running these established companies; three, control residential land entitled, acquired and developed by these strong regional developers; four, acquire land at a discount to current market values and/or participate in the development profit of their operating companies; and five, in some cases, receive homesites on a just-in-time basis.

While we're at the early stages of reshaping our land program, through these three initial partnerships, we will have access to approximately 20,000 additional homesites which should

increase our controlled position to approximately 31% and move us much closer to our 40% goal we announced last quarter, with more to come as these relationships expand. In addition, we are in discussions with regional developers in other markets and we're confident that we can execute similar programs with them.

Before I turn it over to Jon, I'd like to give you an update on LMC, our multifamily development business.

On the brighter side of a soft housing market, our rental apartment business has seen significant pickup in both rents and lease-ups. LMC generated \$42.7 million in operating earnings in fiscal 2018, which was down from 2017 due to a strategic shift from a merchant build-to-sell model to a build-to-hold model. While we still have a pipeline of 30 merchant-build communities with over 9,000 homes and a total development cost of \$3.6 billion, our real focus is to create long-term cash flow and value through the buildout of our Lennar Multifamily Venture I and II.

Lennar Multifamily Venture was our first - number one, was our first build-to-core vehicle where we raised \$2.2 billion from six global, sovereign and institutional investors. The LMV I capital has been fully allocated across 39 assets and 11,673 homes with a total development cost of \$4.1 billion. Of the 39 assets, ten are completed and stabilized, 12 are in lease-up, 16 are under construction and one is about to start construction.

Based on the appraised value of the ten assets that have completed construction and stabilized at the end of fiscal 2018, the current market value of Lennar's investment is \$320 million on our basis of \$219 million, resulting in a cumulative gain of \$101 million. As this venture is held at a historical cost basis, this gain has not been included in LMC's operating earnings and represents future profits for Lennar. In addition, we believe there is significant tremendous built-up gain in the balance of the 29 communities, given that they are fully built out - bid out with strong rent and lease-up dynamics in an improving rental market.

In addition to LMV I, we recently completed the fourth close of LMV II, our second build-to-close vehicle. LMV II currently has committed capital of \$787 million, has one asset under construction and has started predevelopment on seven communities with the total pipeline of 3,015 apartment homes and a total development cost of \$1.3 billion. In addition,



LMV II has six additional seed assets that will be contributed in subsequent closings as additional partners come in through the end of March of '19.

With a total merchant-build and build-to-core pipeline of 83 communities, totaling over 26,000 apartments homes with the development cost of over \$10 billion, we are extremely well positioned to create long-term value for our shareholders in an improving rental market.

And now I'd like to turn it over to Jon.

Jonathan Jaffe: Thanks, Rick.

Today, I'm going to give an update on the merger integration, cost synergies, direct construction cost, SG&A leverage and our production-orientated operating platform driven by our dynamic pricing model.

In our fourth quarter, we completed the integration of CalAtlantic. Everyone is on the same systems, all land purchase are underwritten the same way. All contracts of every type are all the same. All divisions are combined under one roof per market. All new communities are everything's included. We're all on the same page. We are one Lennar.

Next, I want to confirm that we exceeded our cost synergy target of \$160 million for 2018 by about \$10 million. This is split between corporate and SG&A savings and direct construction cost savings at about \$85 million each. We continue to be confident in our prior guidance for 2019 and reaffirm the synergy target of \$380 million. About \$265 million of this is from direct construction cost savings and \$115 million from corporate and SG&A savings.

I want to give some color on what we see with construction cost and in particular with lumber pricing. In the fourth quarter, construction cost increased 7.8% from Q4 2017. We estimate that about 30% of this increase was driven by increased lumber cost as peak lumber pricing impacted our Q4 deliveries.

As the lumber market dropped from \$650 to \$330 per 1,000 board feet in the fall of 2018, we aggressively renegotiated lumber pricing for our fourth quarter starts. We'll begin to see the

benefits of these lower prices with deliveries in - late in the first quarter and receive the full benefit of this lower pricing in the second half of the year.

An additional 20% of the increase was in framing labor. So the combined labor and material for framing represents 50% of that increase.

In 2019, under the platform of one Lennar, we're focused on continuing to be the Builder of Choice to the trades and on value engineering to reduce cost as an offset to the ongoing cost pressures from the constrained labor environment. Given our size and scale in the majority of our markets, our Builder of Choice program is presenting itself in the form of increased interest from trades in bidding our communities. While this has not yet resulted in lower cost, we're beginning to see the opportunity for a more stable cost environment and more predictable production schedules as more trades choose to work for us over other builders.

Additionally, if the market continues to remain soft, our production-oriented focus will allow us to move quickly to realize reduced cost in an accelerated production pace. Or if the market returns to normalized levels, we will have a superior position with more homes started and available to sell and the critically needed trade base to deliver them.

With our combined size and scale, we're able to leverage our SG&A to all-time lows of 7.9% in Q4 and 8.5% for fiscal year 2018, improvements of 50 basis points and 70 basis points, respectively. Part of this improvement is due to our focus on the sales process by lowering our average realtor commission to 2.4% in Q4, an improvement of 20 basis points year-over-year.

As Rick mentioned, we continue to sell inventory by pricing to market. This is directly related to our dynamic pricing model which demonstrated several clear benefits as we managed through the fourth quarter. Our dynamic pricing model gave us real-time visibility on where we needed to take action and on how to set pricing on a home-by-home basis.

By taking the action of pricing homes to sell at current market conditions, we sold homes earlier in the construction process, including selling more homes prior to construction starting. We ended the fourth quarter with an average of almost three homes per community

sold prior to construction starting, a historic high for the company. Our dynamic pricing focus resulted in our ending the year with an average of 1.1 completed inventory homes per community, which is the same exact level of inventory that we had at the end of 2017.

Comparing inventory to the end of last year, a time which was both prior to the merger and in a significantly better market, validates the effectiveness of our operating model.

In the short term, by selling homes earlier in the process, we will have a lower backlog conversion ratio in exchange for improved cash flow and minimized incentives. And over the long term, we expect to see an improvement in our return on investment.

As we enter 2019, we're well-positioned with an efficient overhead structure and a focused Builder of Choice operational program that will allow us to execute effectively through either soft or improving market conditions.

Moving forward, we plan to maintain our existing construction start pace and to use our dynamic pricing model to enable us to price to current market conditions as they evolve. By executing this strategy, we will take advantage of a strong spring selling season with increased earnings and cash flow or in the case of the continuing soft market, we'll maximize our cash flow and return on inventory.

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

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

So our reported fourth quarter EPS was \$2.42. When you add back the net of the gain on the sale of Rialto with other nonrecurring Rialto expenses, purchase accounting adjustments and acquisition and integration costs, our adjusted EPS was \$1.96.

So that's a very high-level view of our results, so now let me walk you through some of the details of our fourth quarter. Some of these items have already been highlighted, but let's start with homebuilding.

Revenues from home sales increased 79% in the fourth quarter, driven by a 64% increase in wholly owned deliveries and a 9% increase in average sales price. From a pro forma perspective, our Q4 2018 deliveries increased 17% from pro forma 2017.

Our fourth quarter gross margin on home sales was 22.1%, excluding the CalAtlantic purchase accounting write-up of backlog and construction in progress. The prior years' gross margin was 22.4%.

Our gross margin was impacted by an increase in cost which was partially offset by an increase in average sales price and an increase in sales incentives. Sales incentives improved 10 basis points to 5.6% from 5.7% in the prior year.

Our fourth quarter SG&A was 7.9%, which was the lowest quarter SG&A in the company's history compared to 8.4% in the prior year. As Jon mentioned, the improvement was due to improved operating leverage as a result of increased volumes as well as efficiencies in our sales process and continued focus on obtaining benefits from our technology initiatives.

So as a result of the above noted gross margin and SG&A percent, our fourth quarter operating margin was 14.2%, excluding the write-up of backlog and construction in progress compared to 14% in the prior year.

We opened 139 new communities during the fourth quarter and closed 122 communities to end the quarter with 1,329 active communities. New home orders increased 44% and new order dollar value increased 49% in the fourth quarter, and our cancellation rate was 19%.

From a pro forma perspective, our Q4 2018 new orders decreased 2% year-over-year.

And one point regarding deliveries and new orders, in connection with the CalAtlantic merger, we reassessed how we evaluate our business and allocate resources. As a result, we modified our homebuilding operating segments into four reportable segments -- East, Central, Texas, and West. All prior-period information has been adjusted to conform with the current presentation, and we will be filing an 8-K with the pro forma deliveries and new orders information for 2017 and 2018.

Jon mentioned, as a result of our focus on inventory management and with the assistance of our dynamic pricing tools, we ended the quarter with 1,451 completed unsold homes, which is 1.1 homes per community. And this is the low end of a very long-term range. And so obviously, inventory is being carefully managed. At the end of the quarter, our homesites owned and controlled were 270,000, of which 202,000 are owned and 68,000 are controlled.

And finally, the fourth quarter joint venture land sales and other category had a combined earnings of about \$1 million compared to \$12.4 million in the prior year, primarily as a result of the valuation adjustment related to assets at a joint venture.

So then turning to Financial Services, in the fourth quarter, our Financial Services segment had operating earnings of \$58.7 million compared to \$42.1 million in the prior year. Mortgage operating earnings increased to \$43.9 million from \$27.8 million in the prior year. Originations increased to \$3.1 billion from \$2.5 billion -- 98% of originations were from purchase business while only 2% were from refis. Mortgage's higher volume, primarily from the CalAtlantic combination, drove significant operating leverage, notwithstanding a more competitive mortgage market from the decline in refis.

Capture rate was 74%, the combined Lennar and CalAtlantic, versus 80% in the prior year, which was Lennar only. Historically, CalAtlantic's capture rate was lower than Lennar's, so we should see some continued improvement in our combined rate as we capture more of that business.

Title operating earnings increased to \$18.2 million from \$14.6 million in the prior year. The increase was due to the addition of CalAtlantic closings and a greater mix of purchase business with higher transaction values versus the prior year.

Turning to Multifamily, our Multifamily segment had operating earnings of \$33 million compared to \$38.6 million in the prior year. In the current year, we recorded \$22.2 million of equity in earnings from the sale of two operating properties, \$15.7 million gain on the sale of our investment and operating - in an operating property, and a \$5.8 million promote revenue related to properties in LMV I.

And then turning to Rialto, as we mentioned in the fourth quarter, we concluded on the sale of our Rialto Investment and Asset Management business for \$340 million. So beginning with our first quarter of 2019, our Rialto Mortgage Finance earnings will be reported with LFS's earnings and the remaining Rialto assets, primarily are fund investments of approximately \$300 million, will be reported as other in our P&L and balance sheet.

Our tax rate for the fourth quarter was 23%, which was lower than our anticipated 24%, primarily due to a favorable state tax settlement finalized during the quarter.

And then turning to the balance sheet, we ended the quarter with \$1.3 billion of cash. As Stuart noted, we repurchased 6 million shares for \$250 million. And we had continued success with delevering, as Stuart mentioned in his opening comments.

As we look forward to - as we look to the full year of 2018, our homebuilding operations generated about \$2 billion of cash flow, excluding the acquisition of CalAtlantic. And we retired \$1.7 billion of Lennar senior notes.

Stockholders equity grew to \$14.6 billion and our book value per share grew to \$44.97 per share.

So as we go to guidance for the first quarter, in '19 we expect new orders between 9,700 and 10,000 in the first quarter. As Rick mentioned, we expect to deliver between 9,000 and 9,500 homes. We expect our Q1 average sales price to be about \$410,000. We expect our Q1 gross margin to be in the range of 20% to 20.5% and our SG&A to be in the range of 9.5% to 9.8%. And for the combined category of joint ventures, land sales and other, we expect a Q1 loss of approximately \$15 million.

We believe our Financial Services earnings will be between \$20 million and \$22 million. We believe our Multifamily earnings will be about \$5 million. And we expect our Q1 corporate G&A to be about 2.2% of total revenues. We estimate that our tax rate will be 25.5% and our weighted average share count should be approximately 322 million.

Man: Shares.

Diane Bessette: I'm sorry, 22- 322 million shares. And as we mentioned, for the full year, we expect to deliver over 50,000 homes.

So with that, we'd like to turn it back to the operator for questions.

Coordinator: Thank you. We will now begin the question-and-answer session.

If you would like to ask a question, please press star followed by the number 1. Please unmute your phone and record your name when prompted. Your name is required to introduce your question. To cancel your request, you may press star followed by the number 2. And as a reminder, please limit yourself to ask one question and one follow up at the time.

One moment, please, for the questions to queue up.

Our first question comes from the line of Ivy Zelman from Zelman & Associates. Your line is open.

Ivy Zelman: Good morning and congratulations on a strong quarter in a tough environment, especially the SG&A leverage.

You know, you've given somewhat guidance, given that you expect to hit your 50,000 unit delivery goal for '19 as well as your goal to hit your synergies that you've outlined for the integration. So when we think about, you know, prioritizing strategically, how you see yourself in a market that might remain sluggish or continue to moderate, if you think about that goal of 50,000, it sounds like you're going - focusing on volume at the expense of margin. Is there a range of margin where you'd actually pull back because it's below what you would feel as an acceptable level and therefore you would maybe fall short of that 50,000 or you're going to monetize your volume no matter what and, you know, navigate through what might be more challenging environment?

That's my first question. I have a followup.

Richard Beckwitt: So, Ivy, I'll start off and then I'll flip it over to Stuart and Jon. This is Rick.

We're really geared up as a production-oriented builder right now. And, you know, given the tight labor and market, we feel it's extremely important to keep our production pace up. We have the land that's in queue and our intent is to build and deliver more than 50,000 homes this year, even if it's at the expense of some margin. We know that it's important to generate cash flow. It's important for us to leverage our G&A. And I think that's the best operating model that we can have in this environment. And if builders pull back with the market softness, we're going to increase our share.

Stuart Miller: I think Jon highlighted it well in his comments and noted that, you know, we're going to continue producing. And there could be some impact on margin if the market continues to be soft. But that'll hold us in good stead. If the market comes back, as we fully expect it will, we'll be profitable with strong cash flow. And if profitability comes down a little bit, we'll still have strong cash flow. And that's the strategy going forward.

Jonathan Jaffe: I'd only add, Ivy, that, you know...

Ivy Zelman: Do you think that...

Jonathan Jaffe: ...if the market does remain...

Ivy Zelman: ... - okay. Sorry.

Jonathan Jaffe: ...slow, we'll have some offset to margin pressure from reduced cost as what is now a very constrained labor market will become more available through lower production levels in the industry.

Richard Beckwitt: And the ancillary benefit will be, as we see in the land market when builders adjust their pace, there'll be incremental opportunities for us to step into some land positions that will be attractive at lower cost basis. So we're continuing to move forward.

Ivy Zelman: Thank you. That's very helpful. You know, in listening to your prepared comments, really, what we didn't get was sort of a little bit more in the weeds. Maybe take us through sort of the, you know, best-performing markets and where you've seen weakness, maybe more weakness above the average. But, you know, also price point, are you seeing difference in



overall activity based, whether it's affordable or a move-up or luxury? If you can walk us through some more details on regions and product, that would be helpful. Thank you.

Jonathan Jaffe: Sure, Ivy. It's Jon. I'll start and turn it over to Rick.

No. No surprise as you see in your fieldwork. We see more activity, better absorption pace at the lower price points. And as you move into the mid kind of price points, we saw stability at the beginning of the quarter and then that sort of softened as it went through the quarter. And at the higher price point, you saw the greatest weakness.

Clearly, we saw the greatest differential in absorptions in the higher-priced California coastal markets, so the Bay Area, Orange County. Even to some degree the Inland Empire, which was pretty hot market, saw the effect of what was happening in the coastal markets. Those same coastal markets also affect some market that benefit from them, like, you know, Sacramento or Reno, which typically benefits from people moving out of the Bay Area. So there was a trickle-down effect to, you know, slow absorption pace in those markets. Seattle, which was, you know, really strong market, saw some pullback as well.

So those were the weaker markets. As you look at the east, it's actually pretty stable from an absorption standpoint. But the same patterns of more affordably priced product moving faster and more expensive products appropriately slowing down some.

Richard Beckwitt: Yes, I guess, the only thing I'd add to that, Ivy, is, as Jon said, once you get to the higher price points, the market is there. Buyers are being very particular. But it's a bit softer. With regard to specific markets, I know Houston always comes up with the volatility in the oil market. The market has gotten a little bit skittish above that sort of \$350,000 price. Fortunately, we have a great position in lower-priced communities in that market, and so we've been benefiting.

An example of a real strong market that you wouldn't think of today is San Antonio. You know, we've got a great position at the lower end of that market and that market is extremely strong right now.

Ivy Zelman: Great. Well, thank you. And I'll follow up. I appreciate it. Good luck.

Coordinator: Thank you. Our next question is from Stephen East from Wells Fargo.

Your line is open.

Stephen East: Thank you, and good morning, everybody.

Rick, you were talking about the developer agreements that you've got going on which are pretty intriguing to me. A couple of different things - excuse me. One, you mentioned, you know, that you would participate in profits, potentially, or buy below market. If you could just shed some more light on what you're talking about there? And then what you were just talking about pace versus price, which I totally agree with your strategy that you all ought to be running pace, will this change your pace any? Does it do anything for you on that front?

Richard Beckwitt: Let me start with the land transactions and these programs. Yes, I'm giving a little bit more incremental information each quarter, Steve, because you keep asking. But I really do want to keep some of this close to the vest.

Stephen East: Okay.

Richard Beckwitt: But what I do - what I can share with you is that we have a profit participation in two of the programs, because we made a strategic investment in their operating companies. And through that investment, we'll share in development profits over and above the ability to purchase homesites that are at a below-market cost because of our investment. To the extent that these entities sell land that we don't want to build on, we'll participate in the full profit through our interest in the development entities.

And another - and so we've slightly structured different deals, but in essence, they all have the same type of flavor where we can access land at below cost - below market cost and also participate in the development profits at the entity level.

Stephen East: Got you. Got you. All right. And does that help your - ultimately, does that help your velocity any on the pace of your business?

Richard Beckwitt: Ultimately, it should. In the beginning, since they're coming out of the ground right now, you won't see a tremendous impact in 2019. But the long-term benefit of these relationships will be that we should be able to leverage more G&A -- that's third-party G&A -- at the same point in increasing our return on assets. And that's really the model that Stuart laid out for us in our program.

Stephen East: Right. Got you. Okay.

Richard Beckwitt: That's the whole concept of the land pivot.

Stephen East: All right. All right. And then the other question I had was on the integration savings. Jon, you talked about ahead of schedule, comfortable with the \$380 million. When do you think you get to the \$380 million run rate? And I guess what would be, you know, maybe your biggest risk to not achieving and maybe what could allow you to go beyond the \$380 million?

Jonathan Jaffe: Steve, I don't have in front of me the exact timing of that, but I would say that most of that is in place with national contracts. And we'll see continued improvement as we put in place opportunities that were identified through our workshop - our synergy workshops that took place throughout 2018. So it'll progress throughout the year. The target really is to be there by the end of the year.

Stephen East: Okay.

Jonathan Jaffe: And hopefully we'll be a little bit ahead of that.

As far as what risk there is, given our strategy of maintaining our pace from a volume standpoint, that should not be a risk to it. So I think it's really just in our court to execute. And I got a lot of confidence in our team, from our national purchasing team to our local divisions that we'll execute well on this front.

Stephen East: Okay. Thanks a lot.

Coordinator: Thank you. Question from Stephen Kim from Evercore ISI.

Your line is open.

Trey Morrish: Hey, guys. It's actually Trey on for Steve. Thanks for taking our questions.

So with the uncertainty in the market and your decision not to give annual guidance, I'm wondering if it's reasonable to think that you've scaled back some of your land commitments, not necessarily trying to say you've stopped land buying because we assume that you've continued to buy and develop land. But have you decide to hold off on making some land purchases due to the slowing down and if things reaccelerate, you'll probably put the gas on going back towards those land deals you have sitting on the table?

Richard Beckwitt: So from an overall land strategy - and we're continuing on our land acquisition program. We've expanded it through these relationships with some very strong third-party regional developers. We do opportunistically take advantage of market weakness. When builders pull back from opportunities, it gives us an opportunity to swoop in, generally, on something that could be shovel-ready at a price that's more competitive than it was under contract. This is something that's in the Lennar DNA going back 20 years. And, you know, that's not to suggest that we're going to overpay for something or chase deals in order to get volume. We view things opportunistically and we run our business every day.

Jonathan Jaffe: Trey, this is Jon. I would add, you know, first of all, we're positioned with the land we need for 2019. So we're really talking about as looking forward. And, you know, to that extent - you know, Rick described what we've gotten, some larger relationship transactions. We're really applying that same kind of thinking to the more local and smaller levels. So not a slowdown in pace, but more a change in shift to structuring deals so that as the market presents itself, we're positioned with more option structures than land owned.

Stuart Miller: Let me - it's Stuart. Let me just contextualize this and say that from a strategy standpoint, understand that our overarching view is that the market has paused, that it has reacted to higher prices over years, together with a rapid increase in interest rates. And there's a little bit of sticker shock in the markets adjusting.

Production deficit and supply constraint in the market, we think is kind of a floor. This market is not likely to go down in an accelerated way. And additionally, we think that the

basic economy is strong. Unemployment is low. Wage growth is happening. There is general consumer confidence. And so as we look ahead and we think about purchasing land and we think about volume, while there might be some softness, squishiness in the market, our strategy is really informed by a view that the market is generally healthy. It's going through an adjustment.

And so our land strategy continues to be consistent. As Rick and Jon highlight, opportunistic in nature. But we're moving forward with a fair degree of confidence that the market will self-correct.

Stephen Kim: That makes a lot of sense. Thanks, guys. It's Steve Kim. I'm on again now.

I wanted to move to a question about demand, I guess. You made some intriguing remarks about how incentive - traffic picked up in December as rates eased. You know, obviously our expectation is that they'll ease a little more here in January. And you indicated that incentives were reduced as well. I was curious first off if there was any geographic differences to call out and I think, specifically, what clients and investors are focused on is California, whether or not what you describe could be applied to that market as well.

And then related to demand also, the government shutdown is also something that's sort of an exogenous factor. And I was curious if you could give some sense as to whether you think that's having any impact or likely to have an impact on the ability of buyers to - buying to rebound, maybe particularly in the DC market or maybe any other markets you might want to call out. Thanks.

Jonathan Jaffe: Hey, Steve, it's Jon.

First, simply, on the government shutdown, we've not seen any impact from that to the market in the DC area. Relative to California, as I mentioned earlier, we've, you know, seen, I think, the biggest delta in change in absorption pace. So as we saw towards the end of the fourth quarter, you know, more incentives to sell homes that will be delivered going forward to sort of stimulate the market given the nature of that magnitude of change. And what we see more currently through December is sort of a firming - you know, better traffic, better

quality traffic and a firming of the pricing opportunity because of more of a willingness to buy from the traffic that we're seeing.

Stephen Kim: Yes, that's really encouraging, Jon. But would you say that what you're seeing in California is mirroring what you're seeing across the nation or do you think it's actually, you know, maybe a little bit better, you know, a better response?

Jonathan Jaffe: No, I wouldn't say it's better. I'd say it's probably still lagging a little bit. So firmer than it was, but still as - on a comparison basis, not as healthy yet as the rest of the country.

Richard Beckwitt: But in either case...

Stephen Kim: Got it.

Richard Beckwitt: ...you know, our operating model right now is to continue production and to solve for margin. And, you know, so the thing at risk in the P&L will be where that margin goes to. And if we need to sacrifice margin in order to keep pace, in order to maximize net operating margin, that's what we're going to do.

Stephen Kim: Yes. Got it. Makes sense. I agree with that strategy.

Thanks very much, guys. I appreciate it.

Coordinator: Thank you.

Our next question comes from Michael Rehaut from JPMorgan.

Your line is open.

Michael Rehaut: Thanks very much. Good morning, everyone.

First question I had was just following up on some of the remarks around the more recent trends and the, you know, the stock kind of moved pretty aggressively following earlier comments around the traffic picking up a little bit in December. And I just wanted to

compare that, if possible, given that, you know, it seems like the market is focusing on these comments pretty strongly here just to get some more clarity around it. You know, because the guidance for the first quarter, if you look at it on a pro forma basis, looks like you're expecting orders at the midpoint to be around down 10% year-over-year on a pro forma basis versus down 2% in the fourth quarter.

So when you talk about traffic picking up a little bit in December, I was curious if you saw any type of similar pickup in order trends, because it does seem like from the guidance things, you expect the sale - I would assume the sales pace and the trends to still be worse in your February quarter versus your November quarter.

Richard Beckwitt: So what's difficult to project and look at is, you know, we're basing our pickup in traffic on a December month, which is a very seasonably slow month. What we have done with regard to first quarter expectations is take, basically, sales absorptions and sort of streamline that over the next three months in the quarter, which is resulting in a down year-over-year on a pro forma basis, but we don't feel it's appropriate to give guidance that picks up an activity that's above what we've seen in the field.

So what we're trying to do is just be straight up with you as we did last quarter. And I think that's what you're seeing in the numbers.

Michael Rehaut: So just to clarify before I ask my second question, you're saying that you haven't seen a similar pickup in sales pace in terms of actual orders in December, just more on the traffic side?

Richard Beckwitt: We saw increased traffic, increased qualified traffic, increased folks willing to buy. But as you look at December versus other months, it's a seasonably low month of the year, so it's difficult to, you know, to use that as a barometer for the rest of the balance of the year.

Stuart Miller: It's really hard at this time of year to get a reading from the market, because the season tends to impact what you're getting as a feedback loop. And so we're not extrapolating that forward, we're giving you a sense of what we're seeing.

Michael Rehaut: No, very much appreciated and understood.

Secondly, turning more big picture, I wanted to circle back also to your land initiatives, your partnerships with the three different developers. And, you know, you described that you have over - still around over 200,000 lots owned, which would be on forward numbers, you know, about four years of owned year supply of land. As you develop these relationships, as you continue to shift towards the land-light strategy or lighter, where could you see, you know, that four-year supply go over the next two to three years, particularly given, you know, that there is still some uncertainty and as this cycle matures, you know, I presume that, you know, you want that, you know, a lighter-land position to more and more assert itself?

Richard Beckwitt: Yes, so that's exactly what our program is. You know, we started this soft pivot going back several years ago. You know, coming out of the downturn, we were aggressive buyers of land and we were opportunistic. As we sit today, we're about - you know, last - we ended the year with 25% controlled. Through these additional relationships, we're up to about 31% controlled. And I'm extremely optimistic that we'll get to north of 40% relatively shortly.

And as we move forward and establish these relationships across the country, which I'm confident we'll be able to do, I think we'll be able to exceed what our original goal was, which will allow us to get better returns and achieve all the benefits we identified.

Michael Rehaut: Great. Thank you.

Coordinator: Thank you. Question from Nishu Sood from Deutsche Bank.

Your line is open.

Nishu Sood: Thank you.

I wanted to ask about the lumber comments. If framing and lumber in total have been driving half of the 7% year-over-year increase in direct construction cost and that that will abate by about 2Q, that would seem to be a pretty big boost to gross margins, you know, following 1Q. Would that be enough to, you know, kind of get gross margins back to level year-over-year or is it not giving enough given the incentive pressures?



Jonathan Jaffe: Well, first, let me clarify that the combined labor material is about half of that, 50% as I said. The material portion of that lumber is about 30%. So as we see lumber recover in pricing and we've got that locked in, you could translate that to, on average, between \$3,000 to \$3,500 per home lower cost going through our system.

You know, I think at the same time, the reality is that in the current environment, there is a constrained labor situation with upward pressure on labor cost. Given that we expect the market to stabilize, we really don't see an improvement in that environment. So we sort of see those as offsetting. And so I wouldn't look at a full recovery of margin just from lumber.

Stuart Miller: You know, when we - we've been careful not to give too much guidance looking ahead, because there is uncertainty. As I highlighted in my remarks, there has been some pressure on pricing that's come from the market, which is, you know, downward relative to margin. There's also been pressure from other materials, labor and land pricing. These moving parts are going to continue to define themselves as we go through the first and second quarter of the year. That's why we didn't want to give too much guidance because we are in an uncertain moment.

Let's wait and see how they resolve themselves. Certainly, there's some tailwind coming from lumber. We know that. And we'll see if it's enough to kind of help stabilize margins. It's a good question, but we'll have to wait and see.

Nishu Sood: Got it. Got it. No, that's very helpful.

And then the second question, you folks have demonstrated, through cycles, you know, going back, obviously, the past couple or even more, you know, a nimbleness as market conditions adjust. And so I would expect, you know, with the weakness having started during a seasonally slow period of year, that nimbleness was probably an advantage. But as the spring selling season comes and if demand hasn't picked up, it might argue that the broader incentive - you know, incentives out there in the marketplace might increase as people catch up in terms of - you know, as the demand gets heavier during the spring selling season.

Am I thinking about that the right way? Are you concerned that as the spring selling season comes around that the incentive pressure may mount?

Stuart Miller: I think that's a good framing of exactly the topic. It's why as we sit here today, we aren't going too far - getting too far ahead of ourselves and looking at where the market is. There are those moving parts. And we certainly might have to use additional incentives if the market does not get - does not start to accelerate as we go into the spring.

But I want to go back again to my comments, Nishu, and highlight that we're still dealing with production deficit. We're still dealing with a fundamentally strong economic foundation, low unemployment, wages going up, consumer confidence generally strong. There are factors - macroeconomic factors that can adjust that and we don't underestimate that. But we still feel that the base for housing has a more limited downside and a significant upside as inventories are low, production has been low. We're certainly seeing that one of the great beneficiaries of a slower home sales environment is the rental market, meaning our rental program has been doing extremely well. And so it means that demand is out there. Need for dwellings are out there and we think that the market is going to continue to be relatively strong as we get into the selling season.

Nishu Sood: Okay, thank you.

Stuart Miller: Welcome.

Coordinator: Thank you.

Stuart Miller: Let's go with one more question.

Coordinator: Okay. Our next question is from John Lovallo from Bank of America.

Your line is open.

John Lovallo: Hey, guys. Thank you for fitting me in here.

Maybe just going back on the incentives for one second just to make sure I understand. You know, understanding that the incentives kind of picked up going, you know, into the quarter,

then they came down post-quarter, I mean would you say that, you know, that you're back to kind of levels now that you were seeing pre-quarter in terms of the incentives?

Richard Beckwitt: So this is Rick.

We - our incentives for December, which is really just one month and I just want to - I want to make sure that everybody understands because as I said in my commentary, it's too soon to tell where things are going to go. But the incentives for December were consistent with our quarter for the third quarter of last year - of fiscal 2018. So we saw a market improvement in our sales incentives.

That said, you know, as we've discussed throughout the call, we're going to continue our program and price to market. And if we have to incentivize more or less, we're going to move inventory.

John Lovallo: Got it. You know, that makes sense. I mean - and, Stuart, maybe just, you know, a more strategic question. You know, you've talked a lot about the reversion to core and kind of the technology implementation. How are you thinking about kind of the opportunities on the construction side itself? Are there things that you're looking into that, you know, could help make that more efficient?

Stuart Miller: So good question. You've heard us talk a little bit more about the technologies around Financial Services. All of these discussions have roots some years ago, meaning they don't start up last quarter and we will report them next quarter. We're working on these things over years and we're starting to discuss them as they bear fruit and as they become relevant to the way that we're configuring our company.

Just like we're focused on some of the fintech solutions that are now coming to fruition, we have been hard at work, particularly, Jon has been hard at work at the tech solutions in and around the production side of our business as well as other components.

There are many ways where we can either partner or develop new technology that can enhance the way that we approach the production process. But they aren't mature enough yet

for us to actually start laying them out and feeding them into the way that we guide you as to the configuration of our business or the way that will impact our business.

But across our platform, many areas, not just construction, also in sales and other areas, we're working on technology solutions and best-of-breed partners that can help us both build the better mousetrap, reduce our overhead and enhance our customer experience. And I hope you're hearing that as we start to articulate this more and more going forward. It's all of those components. A better customer experience, a more efficient operation and using partnerships with best-of-breed leaders like States Title and Hippo to be able to leverage their prowess, their expertise and to build a better program for our customers and for the operations of our company.

That's the program. And yes, it is in the production part of our business as well.

John Lovallo: Great. Thank you, Stuart. And maybe just one last one in terms of community count for the first quarter, how should we be thinking about that?

Stuart Miller: Wow. That's a tough one to sneak in right at the end.

Diane?

Diane Bessette: You know, we gave the new orders guidance, so I think that you'll find that it's pretty consistent on a year-over-year basis. But we can help you do the math with that if you'd like.

John Lovallo: Thank you.

Stuart Miller: Okay. Thank you, everyone. Appreciate your attention for our fourth quarter and year end and look forward to keeping you updated as we go through 2019.