



# **Brookfield Residential Properties Inc.**

## **2012 Second Quarter Results**

### **Conference Call & Webcast Transcript**

**Date:** Wednesday, August 8, 2012

**Time:** 1:00 PM ET

**Speakers:** **Alan Norris**

President & Chief Executive Officer

**Craig Laurie**

Executive Vice-President & Chief Financial Officer

**ALAN NORRIS:**

Good morning, ladies and gentlemen, and thank you for joining us today for Brookfield Residential's Second Quarter Conference Call. On the call with me today is Craig Laurie, our Chief Financial Officer. I will provide some comments on the current markets intrinsic value and outlook going forward. These comments are also reflected in my letter to shareholders which was posted on our website yesterday. Craig will then provide financial highlights of our operations and financial results.

I would at this time remind you that in responding to questions and in talking about our new initiative and our financial and operating performance, we may make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For further information for investors I would encourage you to review our interim report and supplemental information package, both of which are available on our website.

With regards to our first half numbers, our results for the first half of 2012 were very positive. Our income before taxes was \$38 million compared with \$11 million last year from normal recurring operations. As stated in my last letter to shareholders, the comparative statements for 2011 do include certain one-time merger items; throughout this year we will continue to break out normalized and nonrecurring items for 2011 so you can better gauge our performance. Our operating results continue to improve. Lot and housing sales are up over last year and look very positive for the balance of the year with our sales backlog up 52%. Our parcel sales remain on track through June 30th and we have good visibility for the balance of the year. Our credit availability remains high, at over \$180 million at June 30th. This allows us to take advantage of acquisition opportunities in the marketplace, as well as possibly pay down some of the transaction debt resulting from last year's merger.

Our markets in Alberta and Ontario continue to perform well. The unemployment rate in Alberta is now at 4.6% and the last year has seen 61,000 people move to the province.

The Canadian government recently introduced some tightening of the mortgage lending rules by reducing the amortization period from 30 years to a maximum of 25 years on government insured loans. While this will take some people out of the home ownership equation, we agree with the gradual and responsible approach the government has taken to reduce the potential bubble-like situations in the high-rise business in Vancouver and Toronto. Our view, while high-rise is not part of our business model, is that this is having the desired effect. In the U.S. we continue to see improvements in the marketplace, seasonally adjusted annual housing starts for 2012 are currently \$760,000, up 23.6% over last year. While there is no national market in the U.S., just a series of regional markets, it is clear that many of these markets, many of which we do business in, are now experiencing a shortage of new service lots on which to build which is obviously a very positive development for a company such as ourselves.

During the first-quarter conference call we emphasized that while our homebuilding operations are important, we are much more heavily invested in land than many others and, therefore, will benefit significantly in a recovering market as land values appreciate. As a result, the approach to valuing our company should also be viewed differently.

With this in mind, and taking advice from some comments in the past, we have enhanced our corporate profile which is posted on our website and provides more information to help investors and shareholders better understand our business and various approaches to valuing our company.

We remain on track to achieve the performance in our limited guidance for 2012. As we continue to enhance our disclosure we have split out our parcel land sales to show them as acres as opposed to lot equivalent closings. The Canadian operations are projected to close approximately 1,200 lots, 80 acres of multi-family, commercial and industrial parcels and 1,200 homes and the U.S. operations are projected to close approximately 550 homes, which include our share of unconsolidated entities. In addition, there are projected to be several potential bulk lot sales in the U.S. Again, this is consistent with previous guidance in the Q1

call. We are, therefore, optimistic about the balance of the year and believe that our 2012 operating income will exceed last year's normal recurring income.

I would now like to turn the call over to Craig, who will discuss our financial performance for the three and six months ended June 30, 2012.

**CRAIG LAURIE:**

Thank you, Alan, and good morning, everyone. Our results for the second quarter of 2012 improved over the same period last year.

Net income for the three months ended June 30, 2012, totaled \$22 million, or \$0.22 per share, compared to \$19 million, or \$0.19 per share, for the three months ended June 30, 2011. Net income for the six months ended June 30, 2012, total \$22 million, or \$0.22 per share, compared to a net loss of \$38 million, or a loss of \$0.37 per share, for the six months ended June 30, 2011. The first quarter of 2011 included a one-time valuation allowance against the Company's U.S. deferred tax assets on the completion of the merger.

The 2011 financial statements represented the first year as a public company and reflected nonrecurring items as a result of the merger that impacted revenue and net income. Specifically, the first six months of 2011 included \$41 million of income before tax from a nonrecurring change of business practice. In addition, the first quarter of 2012 included \$9 million of interest on the transaction debt that was not included in the comparable period in 2011. Taking these items into account, income before taxes improved \$36 million on a comparable basis over the same period in 2011, reflecting improved operating results on a quarter-over-quarter basis.

For the three months ended June 30, 2012, land revenue totaled \$110 million compared to \$147 million in the same period of 2011. Approximately \$49 million of the revenue from 2011 was due to the change in business practice referred to above. Excluding the nonrecurring revenue, normalized land revenue for the three months ended June 30, 2012, increased by

12% over the same period of 2011. For the three months ended June 30, 2012, housing revenue increased to \$138 million from \$89 million for the same period of 2011 as a result of increased home closings. In addition, the 31% increase in net new home orders in the second quarter, particularly in Canada and Washington, D.C. area, have resulted in a higher backlog of 1,111 homes at June 30, 2012, compared to 733 homes for the same period in 2011, a 51% increase over the same period in 2011. For the six months ended June 30, 2012, land revenue totaled \$153 million compared to \$244 million for the same period of 2011.

Approximately \$110 million of the revenue from 2011 was due to the change in business practice referred to above. Excluding the nonrecurring revenue, normalized land revenue for the six months ended June 30, 2012, increased by \$19 million, or 14%, in comparison to the same period of 2011. This increase in both the three and six months normalized land revenue is driven by parcel sales in California and Canada. For the six months ended June 30, 2012, housing revenue increased to \$227 million from \$172 million for the same period of 2011 as a result of a 32% increase in home closings.

Moving to our balance sheet; as at June 30, 2012, our primary asset, our land and housing inventory, totaled \$2.4 billion, or approximately 87% out our total asset, similar to prior quarters. The balance increased when compared to December 31, 2011, due to acquisitions of \$44 million in the first quarter and \$58 in the second quarter as well as development activity and a strong Canadian dollar. Our land and housing assets include homes completed and under construction, lots ready for construction, model homes, and land under and held for development. Cash flow used in operations for the six months ended June 30, 2012, was \$95 million after \$102 million of acquisitions during the period split \$59 million of acquisitions in Canada and \$53 million of acquisitions in the U.S. The Company worked its balance taking advantage of acquisition opportunities with overall capital planning and believes they will provide an appropriate return based on using today's pricing and absorption.

Thank you for joining us in our quarter end conference call. I'll now turn the call back to the Operator who will moderate questions.

**OPERATOR:**

Our first question comes from Alex Avery, CIBC. Please go ahead.

**ALEX AVERY:**

Thank you and congratulations on a good quarter; it seems like a lot of things are shaping up quite well for the Company. In your commentary you mentioned that I guess the U.S. market is hard to consider as a single market, but that you noted a tightening in the supply of service lots in some markets; can you just give us a little more color on that? Perhaps profile one of the markets that you are in and talk about what that means for lot pricing and the timing of demand?

**ALAN NORRIS:**

Alex, its Alan here; you're bang on; we believe we are in the right markets in the U.S. as you well know. Taking a look at California in a broader sense, there is no question the coastal markets have tightened up considerably and have been for some time. We hadn't quite seen some of the price pressure move into some of the inland areas, but we are starting to see some indicators on that. Too early to tell how substantive that is but we are starting to see some price pressure float into some of the more inland locations. So it's a good sign. The Bay area has obviously been very tight for some time and we are now in a position where we are selling some of the lots and homes that we purchased over the last 12 to 18 months. We are very pleased with that development and those acquisitions that we did do because that market has continued to tighten up; we're seeing price appreciation in the Bay area.

**ALEX AVERY:**

Can you give us a sense of what kind of magnitude you might be talking about in terms of price appreciation in that market?

**ALAN NORRIS:**

Probably on some of the housing I would say we are up about \$20,000 a house versus how we pro forma'd it, just as an example.

**ALEX AVERY:**

And that would be in a price per house of?

**ALAN NORRIS:**

Many of those homes are probably in a range of \$650,000 to \$850,000 I would say, Alex, just to give you an idea, that's a somewhat generic comment.

**ALEX AVERY:**

Okay. Then you highlight some parcel sales that you're expecting in the remainder of the year. I was just wondering how you assess whether you want to pursue parcels sales versus single lot sales, and I guess what goes into that thought process?

**ALAN NORRIS:**

I guess it depends on the product. Some of the parcel sales are some commercial sites that we are selling to end-users who will build the product, for instance, in our Calgary marketplace. So they might be some commercial or industrial lands. We will build some ourselves, but we will sell some, in the U.S., some of the phases may well be lands which we are selling off. We may end up buying one of those phases because it could be coming out of a joint venture. It is really just making sure that there is an appropriate pricing mechanism when we are selling it of JVs. We offer it to other builders and we bid the same as other people. So that is the process that is followed in some of our JVs in the U.S. In some of our communities it is a question of bringing in another builder to drive traffic with us in some of our communities so that we can enhance the traffic flow and the absorptions overall.

**ALEX AVERY:**

Okay. Then just lastly, you noted that your backlog is up 52%; is it fair to assume that the vast majority of that is in Alberta?

**ALAN NORRIS:**

I would say Alberta and Ontario, albeit D.C. is up over past years. I would say those are the three main areas.

**ALEX AVERY:**

Okay, that is great. Thanks a lot.

**OPERATOR:**

The next question comes from Hanif Merali, with Dundee Capital Markets. Please go ahead.

**HANIF MERALI:**

Are the U.S. operations now breakeven? I haven't seen the country breakouts yet but just looking at your margin data, have you reached that point yet in the US?

**CRAIG LAURIE:**

No, we haven't. I would point you to our interim report which we posted on our website last night. On the back page we do break out the segment on Page 51, note 18. We did show that in the U.S. we would have lost just over \$8 million for the six months ended in the U.S.

**HANIF MERALI:**

And you were, I think, \$6 million through Q1 so this one is a little bit less of a loss.

**CRAIG LAURIE:**

Yes.

**HANIF MERALI:**

Can you explain better, the land of strategy as opposed to the home selling strategy in California? I know you have sold some bulk land here, but when do you sell lots there?



**ALAN NORRIS:**

The bulk land was just a one-off parcel that we were selling for other reasons. That land we weren't planning to develop based on some of the other factors related to that particular piece. But I would say that, similar to what I mentioned in the first answer, is that if we are in the community where we are building ourselves we might sell off some other phases to builders depending on the different product types that we are looking to create and segment the market to provide better choice for the consumer and drive traffic and enhance absorptions. So, as opposed to just building only in our own communities and being the sole builder, we will look to bring in competition as long as we are segmenting the product offering and provide better choice to the consumer.

**HANIF MERALI:**

Okay. Next question on the planned acreage sales to commercial industrial in Canada; you've still got a lot to go based on the 80 acres you are suggesting. Are the values of the balance, the 60 acres, you got a very good price for that in Q2; are the per acre values going to be similar going forward?

**ALAN NORRIS:**

I would say so. On the commercial side, yes, the industrial is a slightly different price point, but most of these transactions that we have visibility over are obviously under contract right now. And many of them could be subject to, for instance, development permit approval at the city. So the contracts are all signed for the most part for those deals, it's a question of timing for their final approval for the end-user as to whether they get it approved through the city. Usually it is just a passage of time issue as opposed to anything else.

**HANIF MERALI:**

Okay. And an explanation, you explained the U.S. strategy; how come so many more lots that you sell without your own homes are on the Canadian side? Is it just the nature of the communities being developed or what?

**ALAN NORRIS:**

Typically taking the Alberta operations as an example, with the communities that we develop here we are very much more of a master plan developer and we might only build on up to 20% of the lots in our own community and then sell off the other 80% to third-party builders. So, we try and limit somewhat the building in our own communities on a particular segment so that we don't compete as much with our customers. This allows us to enhance absorptions and bring volumes up somewhere around 350 to 500 lots per year in some of our communities through a variety of builders as opposed to just trying to do it all ourselves. It just provides, I believe, a better community with more choice and it doesn't make us as G&A intensive by being so vertically integrated that we have to build everything ourselves.

**HANIF MERALI:**

Okay. Given the state of the Eastern and Central U.S. markets, I mean you're still posting a loss on the land in the second quarter. Given the activities that are happening, will those losses turn into profits soon enough at a gross margin level?

**ALAN NORRIS:**

Yes, the movement in the marketplace generally is positive. It doesn't move the needle substantially yet, but we believe we are moving in the right direction and that we have the patience and the capital structure that allows us to be patient with some of our lands, which aren't quite ready to be brought on. We are seeing good indicators in most of the markets which provides pressure and constraints on supply in some of the inner rings, which provides some pressure elsewhere in the marketplace, which only can benefit us in the longer run.

**HANIF MERALI:**

Okay. Last one, the SG&A last year; I have looked at the last six quarters, they still run \$25 million to \$30 million; what was the anomaly last year?

**CRAIG LAURIE:**

As you mentioned, we normally run about \$30 million. \$21 million on the G&A part and then the sales and marketing could be between \$7 million and \$9 million, that is what you would have seen this year. During the second quarter of last year we did have a change in our compensation program as a result of the merger, which did result in a credit to G&A of approximately \$8 million, and so that is why it is down last year.

**HANIF MERALI:**

Okay. And I guess if I could squeeze one last one in. This tax asset that you bought in Q1, what was I guess the nature of that? Is the payback in one year or?

**CRAIG LAURIE:**

We didn't purchase a tax asset. I'm not sure what your question is referring to. We took the valuation allowance last year.

**HANIF MERALI:**

No, no. In Q1 there was some sort of tax loss purchase.

**CRAIG LAURIE:**

We purchased tax credits that just paid for our tax liability, within Canada.

**HANIF MERALI:**

Okay, so it is a marginal return on this I guess?

**CRAIG LAURIE:**

It is just a payment of taxes. We purchased Part 6.1 tax; it was the purchase of Part 6.1 tax credit which are in payment of your taxes.

**HANIF MERALI:**

Okay, all right. Okay, that is it, thank you.

**OPERATOR:** Our next question comes from Stefan Mykytuik, Pike Place Capital. Please go ahead.

**STEFAN MYKYTUIK:**

Good morning. Getting back to kind of the market environment in the U.S., I know you talked about California improving. But listening to some of the other public homebuilders' earnings calls it sounds like, even in Denver and Texas and some of these other markets, lots are getting tighter and a lot of the builders who are trying to run an asset-light strategy are now realizing that they are kind of scrambling for land and lots to build on. Are you seeing that in those markets in your business as well, or is it just most pronounced in California?

**ALAN NORRIS:**

No, Stefan, you're exactly right. When Alex asked the question he just asked to pick one market, so I just picked California, but we're seeing a similar type of tightening in the other markets. I would say in Denver not quite as much. Definitely we're seeing it in Austin. The number of builders in our community down there has gone from two to five, and so we are getting many more inquiries. So, we're seeing some tightening and we're seeing more players looking to get back into the marketplace. Denver is an example; many of the nationals exited that market and I know there is some talks about them coming back in and doing other things and raising their profile somewhat. We have just started up our house building operation in Denver right now. So we're optimistic that we're going to be able to monetize some of the lots that we have got, because we were somewhat at the whim of some of the remaining company builders that were in the city, that we were not being able to move as many lots as we could. So, hopefully, that is a positive step when some of them come back again and we have our own house building operation as well.

**STEFAN MYKYTUIK:**

Okay. Then within California, I know you touched on it, but again listening to other homebuilders it sounds like some of those; the Inland Empire, Sacramento, some of those tertiary markets, are starting to pick up a little. I think you said you're seeing some of that; in terms of your willingness to monetize some lots there are you more likely to wait until things improve further before you start to monetize or is there a little testing of the waters that we may see in the second half of the year?

**ALAN NORRIS:**

That's a great question. What we are seeing is we have hung in there over this period of time and what I'm not going to do is -- unless we saw significant volume we would not be selling off some of those great positions that we own in the Inland Empire. However, if we saw some good value, we might look at it. What we might be doing now is we might be having another builder come along with us to help create value and create that synergy and that competitiveness to launch the community a little bit better, which positions us better for next year or the year after or whatever. But there is not going to be any we see the first glimmer and we are going to start selling lots unless there is real value. We believe, when you look at the dynamics, there is going to be pricing pressure which is going to see increased value for those lots in those areas. And we would have to be comfortable we were being rewarded for that, otherwise we will hold and we will develop it in the appropriate time and realize that value ourselves.

**STEFAN MYKYTUIK:**

Okay. I seem to recall in Northern California you have got some homebuilding projects that are coming online more in the second half. Did I remember that correctly?

**ALAN NORRIS:**

Just as an example, we just opened up last weekend for one of our projects. It is very, very small numbers. We released 10 homes in one product, six in another, and out of those 16 we sold 15 of them on the weekend, so very positive. We will be releasing more again this

weekend and the weekend after. So just some positive developments from some of the pent up demand and some of the constraints on supply in that marketplace as I alluded to earlier.

**STEFAN MYKYTUIK:**

So you open up 16 and you sold 15 of them already?

**ALAN NORRIS:**

We did, yes.

**STEFAN MYKYTUIK:**

Okay, that's good. So, in terms of the pace of the business, last year Q2 was kind of on, adjusting for the nonrecurring, pulling out the nonrecurring, Q2 and Q3 were kind of similar quarters. Do you expect the pace of the business to be similar this year, or is there some improvement to the back half?

**ALAN NORRIS:**

We always tend to go a little bit backend loaded from a Q4 point of view on some of the occupancies on the housing side. And a few of the parcel sales are probably backend loaded just from a timing point of view from some of the approvals that some of our users are trying to get from, say, the City of Calgary as an example, so, those approvals will not come through until Q3, Q4.

But I think we are optimistic; as I said in my remarks and also the report to shareholders, we're optimistic. Our vision for the back half of the year is that we will improve well over the recurring income from last year, just for the normal income for this year. So we're positive. We have house closings, we have got some better margins, and we will get a few other deals going along. So we are quite optimistic where we are sitting right now.

**STEFAN MYKYTUIK:**

Right. So, Q3 may be a little better than Q2 and then Q4 is kind of a much better quarter because of what goes on in Canada?

**ALAN NORRIS:**

Yes, some could slide into Q3 - Q4 but generally speaking I think we are tending to look at the last six months. But, yes, I get your point, we're feeling fairly decent, we have got good visibility the last six months. Whether all things happen right in Q3 or roll into four, I would say more will fall into four than three. But I can't remember exactly what our numbers were Q3 last year to see whether it is exactly the same, but overall we believe we are going to be better than the recurring income from last year.

**STEFAN MYKYTUIK:**

Well, last year at Q3, on the recurring basis, I think was pretty much equal to Q2 and then Q3 was dramatically different. Or Q4, rather, was dramatically better. Okay, terrific. Thanks so much.

**OPERATOR:**

The next question is a follow-up question from Hanif Merali, with Dundee Capital Markets. Please go ahead.

**HANIF MERALI:**

I haven't seen the restatement of Q3/Q4 but were there any nonrecurring in those quarters still?

**CRAIG LAURIE:**

This is Craig. I can tell you the page in the supplemental, if you have it. If you go to the bottom of page five it shows the last eight quarters and then it shows you the nonrecurring, so it was a net \$9 million for the last half of 2011.

**HANIF MERALI:**

Okay, thank you very much.

**OPERATOR:**

There are no more questions at this time. I will now turn the call back over to Alan Norris for closing remarks.

**ALAN NORRIS:**

Thanks very much. Thank you very much, everyone, for participating in the call. Hopefully, you join us for Q3. If there are anything else that you would like to inquire, please don't hesitate to contact us. Hopefully, our supplemental information and corporate profile and enhanced disclosure help you understand our company better. And we look forward to your future participation. Thank you.

**OPERATOR:**

Ladies and gentlemen, this concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.