



## **Brookfield Residential Properties Inc. 2011 Year End Conference Call Transcript**

**Date:** Wednesday, February 15, 2012

**Time:** 11:00 AM ET

**Speakers:** **Alan Norris**  
President & Chief Executive Officer

**Craig Laurie**  
Executive Vice-President & Chief Financial Officer

**Alan Norris:**

Thank you. Good morning, ladies and gentlemen, and thank you for joining us today for Brookfield Residential's Year End Conference call. On the call with me today is Craig Laurie, our Chief Financial Officer. I will provide some comments on the current market conditions, our accomplishments over the last year, and specifically since the merger on March 31, 2011, and the 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 will be available on our website.

Our performance in the fourth quarter was extremely positive, particularly due to our Canadian operations. As we discussed on previous calls and as anticipated, a significant portion of our 2011 income before taxes was back-end loaded to the fourth quarter, with \$49 million of our income before taxes occurring in this quarter.

Our Canadian operations continued to perform well, with strong sales carried forward into 2012. Our future looks good also, with Alberta's unemployment rate now at only 4.9%. Thousands of jobs were created in 2011, many related to capital projects slated for Northern Alberta. Given the normal time lag between job creation and home ownership, this all bodes very well for our future in Alberta.

There have been press articles concerning a housing bubble in Canada. However, when these are analyzed closely the concerns primarily surround housing prices in Vancouver and high-rise prices in Toronto, neither of which are areas or segments that we operate in.

In the U.S., while we see some signs of optimism, the markets still remain challenging. We are, however, well positioned in our targeted real estate markets and where good acquisition opportunities exist.

As we reflect on our accomplishments since the merger on March 31<sup>st</sup>, there are many. We effected the management changeover seamlessly and have our next-generation leaders in place, while our seasoned managers are still available to coach and mentor. We amended the terms of two of our related party debt obligations in order to ensure we have sufficient liquidity for future opportunities. As of December 31, 2011, we have over \$144 million of available lines of credit in Canada and \$74 million available in the U.S. We acquired \$140 million of land in Canada and the U.S., which we believe will provide an appropriate return based on today's pricing and absorptions. The vast majority of these lands are short-term in nature and will provide returns over the next one to three years.

Included in my comments in the last conference call, I mentioned we were committed to providing more information to investors to better understand our key competitive advantages and, in turn, accurately value the company. With that in mind, our press release provides more financial information and the corporate profile posted to our website provides more detailed information on our land and housing inventory.

I will also profile one or two projects in each quarter in a letter to shareholders to describe the types of assets that we own and how we apply our philosophy of development. While the bulk of these projects are residential in nature, we also create commercial and industrial lands that may form part of several of our master plan communities. We generally build homes on 15% to 20% of our own land with the remaining lots and parcels being sold to third-party builders. Our portfolio is unique in the North American marketplace and places us in the advantageous position of having solid cash flows and performance from our Canadian operations, with good optionality and upside from a U.S. housing recovery. Our discipline and in-depth knowledge of the North American market bodes well for this to occur.

Our view for 2012 is for similar, but marginally improving markets in North America. We are hopeful that with the opening of several new communities in the U.S., some commercial parcel sales and executing on our excellent sales backlog, our 2012 normal operating income will improve and replace some of the non-recurring income of 2011.

Thanks to all our employees, building partners, trade partners, consultants, lenders and shareholders. It's an exciting time to be in the business and we look forward to sharing it. I'd like now to turn the call

over to Craig, who will discuss our financial performance for the 3- and 12-month period ending December 31, 2011.

**CRAIG LAURIE:**

Thank you, Alan, and good morning, everyone. Given the state of the North American market and the impact of the merger, our overall performance for the year is reasonably positive. Our income before taxes for the year of \$130 million is broken down as follows; \$81 million in income from normal recurring operation, and \$49 million of income from a non-recurring change of business practice as a result of the merger.

Minority interest and the tax provision of \$123 million, including the write-off of the U.S. deferred tax asset, brought our net income down to \$7 million, or \$0.07 per share, compared to net income of \$168 million, or \$1.11 per share for the year ended December 31, 2010. The decrease in net income primarily reflected increased interest expense of \$37 million, resulting from the transaction debt, and the income tax valuation of \$71 million. Results in 2012 should be more straightforward, as these nonrecurring items are now behind us.

The company currently sells from 21 active land communities and 33 active housing communities. From these communities, the company closed 3,653 lots and 1,330 homes for the year ended December 31, 2011.

The company's average selling price of land delivered for the year ended December 31, 2011 was \$151,000 per lot compared to \$139,000 during the same period last year, with the increase largely a result of product mix. The company's average selling price of homes delivered during the year of 2011 was relatively consistent at \$374,000 compared to \$375,000 during the same period last year.

For the year ended December 31, 2011, land revenue totaled \$524 million compared to \$355 million for the same period of 2010. Approximately \$189 million of the increase was due to the change of business practice. Gross margin on lot sales for the year ended December 31, 2011 were 44%, similar to 2010.

For the year ended December 31, 2011, housing revenue totaled \$484 million compared to \$599 million for the same period of 2010, commensurate with the reduced home closings in the U.S. Gross

margins on home sales for the year ended December 31 were 15% compared to 18% for 2010. The decrease is due to reduced volumes and product mix in the U.S. operations. However, net new home orders for the year-ended December 31, 2011 were 13% higher compared to the same period in 2010.

Net income for the three months ended December 31, 2011 totaled \$26 million or \$0.25 per share compared to net income of \$41 million, or \$0.35 per share for the three months ended December 31, 2010. The decrease was primarily a result of the interest expense of \$12 million with the addition of the notes that were issued to Brookfield Office Properties in connection with the merger.

For the three months ended December 31, 2011, land revenue totaled \$165 million compared to \$108 million for the same period of 2010. Approximately \$36 million of the increase was due to the change in business practice previously discussed.

For the three months ended December 31, 2011, housing revenues totaled \$199 million compared to \$191 million for the same period of 2010. Home closings for the three months ended December 31, 2011 increased by approximately 5% in comparison to the same period in 2010. Gross margins on home sales for the three months ended December 31, 2011 were 15% compared to gross margin of home sales for the same period in 2010 of 17%. The decrease was due to reduced volumes and product mix in the U.S. operation.

Moving to our balance sheet; as at December 31st our primary asset, our housing and land inventory totaled \$2.3 billion, or approximately 89% of our total assets, similar to prior quarters in December 31, 2010. Receivables increased by approximately \$50 million from the third quarter of 2011 with the fourth-quarter Alberta lot sales. The mortgages registered on the lot sales generally are for a term of nine months.

Cash flow from operating activities during the 12 months ended December 31, 2011 totaled \$23 million after \$140 million of acquisitions made during the period. The company works to balance taking advantage of acquisition opportunities with the overall capital planning and believes they will provide an appropriate return with today's metrics and absorption.

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

**OPERATOR:**

The first question comes from Michael Drake of BAWAG. Please go ahead.

**MICHAEL DRAKE:**

Hi, guys, just a quick question you just touched on a moment ago in the cash flow; the pretty dramatic increase in accounts receivable and also decrease in payables. I was wondering for the full year, considering that, that is very different from what occurred in 2010. Is it possible if you could discuss what the drivers of those cash outflows were?

**CRAIG LAURIE:**

Sure, this is Craig. So the receivables are a result of our lot sales in Canada this year, particularly Alberta, were very back-end loaded, so a lot of them occurred within the fourth quarter. A high number of those lot sales come with -- we provide mortgage financing for the nine months that I just touched on. So, that's why there's a big increase in the accounts receivable. In terms of the payables, there was nothing special. I think that was just timing.

**MICHAEL DRAKE:**

So these are just timing issues that should reverse hypothetically?

**CRAIG LAURIE:**

Yes.

**MICHAEL DRAKE:**

Can you explain -- I'm not familiar with the nine-month mortgage financing that you're providing on these lots, is that just a temporary financing?

**ALAN NORRIS:**

Michael, it's Alan. Let me just touch on that. It's a business practice that we've done for over 50 years in the province of Alberta here, where you sell lots to third-party builders and the concept is that you take 20% down and you take a note back for the nine-month period and you collect that. It gives the builder time to be working with their customers. It's been a business practices that's been accepted here for many, many years and the bad debts that result from that are absolutely negligible over the

last 30-plus years through all sorts of cycles. So, it's that typically the capitalization of builders does not allow them to be paying 100% cash on day one. So, it allows them to be working with customers and then close on the transaction. So, it's been an accepted practice for many years.

**MICHAEL DRAKE:**

Okay. Can you give a little detail on the \$140 million that you guys spent on land in the quarter and what -- I know this is what you call a short-term project, but can you give us some details on what that means and why are you confident that it's a short-term turnaround for these assets?

**ALAN NORRIS:**

Yes, the \$140 million was over the whole 12 months, not just the quarter.

**MICHAEL DRAKE:**

Oh, okay.

**ALAN NORRIS:**

Just so we clarify that.

**MICHAEL DRAKE:**

That's good.

**ALAN NORRIS:**

So, there was a few projects that we bought, for instance in Northern California, which are -- tend to be more I would call, housing-type ventures, where we are buying finished lots in a situation where it might only be an 80 lot community and we will be building out the homes in that community and the absorptions would be expected to be, say, 30 to 40 units. So, it's a one to two-year build out, as an example. We bought some similar projects, I would say, in Ontario and so there was two or three out in the Bay Area and one in Ontario, and some in Alberta here, which one of them is slightly longer term, another one shorter term. So, generally speaking, the point we're trying to make is that even with extending out the liquidity -- or the terms on the notes, we believe we can make the appropriate returns over the next one to three years on some of these acquisitions and still have the liquidity available on the new maturities for the debt -- for the notes payable.

**MICHAEL DRAKE:**

Okay, thanks very much. That's all for me.

**OPERATOR:**

The next question is from Mike Mitchell of Locust Wood. Please go ahead.

**MIKE MITCHELL:**

Hey, guys, good morning.

**ALAN NORRIS:**

Morning, Mike.

**MIKE MITCHELL:**

On that last point about the \$140 million, can you talk about what types of returns just percentage wise, ballpark it for us, you're expecting on that?

**ALAN NORRIS:**

We'd be looking on an unlevered basis, Mike, to be getting a 20% return on investment.

**MIKE MITCHELL:**

Okay, great. Then the taxes in the quarter, it looked like the tax rate was approaching 50%. Is there something that was driving that? Is that sort of a -- how should we think about the normalized taxes?

**CRAIG LAURIE:**

Mike, this is Craig. So, our overall tax rate on the Canadian earnings going forward in 2012 would be 27%. It was 28% in 2011 and then it would have been 29% in 2010. The future earnings in the U.S. will be sheltered by our NOLs.

In terms of the -- specific to the fourth quarter, much of the Canadian tax expense was pushed into the fourth quarter with almost of all our Toronto taxable income occurring in the fourth quarter. The actual -- if you're just looking quarter-over-quarter the actual Canadian taxable income was quite a bit higher in the fourth quarter of 2011, but you also had a higher U.S. loss in corporate expense in 2011, which



partially offset the growth. When you look on an apples-to-apples basis it would have been about the same rate.

**MICHAEL DRAKE:**

Okay. And you weren't reporting a deduction from U.S. earnings because you're not recognizing that NOL; is that why the tax rate would skew so high?

**CRAIG LAURIE:**

Yes.

**MIKE MITCHELL:**

Okay. So going forward out of Canada, as we think about Canada being profitable, the tax rate will be in the high 20s, something like 27%?

**CRAIG LAURIE:**

Yes.

**MIKE MITCHELL:**

Okay, thank you.

**OPERATOR:**

There are no more questions at this time. I'd like to turn the conference back over to Mr. Alan Norris.

**ALAN NORRIS:**

Thanks, Operator. I wasn't quite expecting that. So, thank you very much indeed for listening in to our year-end conference call. If there are any other questions anybody has feel free to contact Craig or myself, on any other points.