Brookfield Residential Properties, Inc.
2014 Second Quarter Results
Conference Call and Webcast Transcript

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Speakers:

Alan Norris
President & Chief Executive Officer

Craig Laurie
Executive Vice-President & Chief Financial Officer

OPERATOR:

At this time, I'd like to turn the conference over to Mr. Alan Norris, President and Chief Executive Officer. Please go ahead, sir.

ALAN NORRIS:

Thank you very much. Good morning, ladies and gentlemen and thank you for joining us today for Brookfield Residential's 2014 Second Quarter Conference Call. With me today is Craig Laurie, our Chief Financial Officer.

I would, at this time, remind you that in responding to questions and in talking about new initiatives, and our financial and operating performance, we will make forward-looking statements. These statements are subject to known and unknown risks and future results may differ materially. For more information on our Company, please also visit our website.

We achieved very good results in the second quarter of 2014, as we continue to bring new communities to market while capitalizing on stronger lot and home prices. For the three months ended June 30th, 2014, our net income increased to $42 million, or $0.36 per diluted share, from $24 million, or $0.21 per diluted share, during the comparative period in 2013. The improvement in net income was due to improved housing and land gross margins as our overall margin for the second quarter increased 31%, compared to 26% during the same period in 2013.

Our Canadian markets continued to perform at a steady pace, as we operate in markets where barriers to entry are high and economic fundamentals continue to be strong. In particular, the current constrained supply of entitled lots in Calgary, coupled with strong demand, has resulted in price escalation. To ensure appropriate continuity, we continue to show a disciplined release of lots until further entitlements of lots and new projects are approved.

We believe that the underlying fundamentals in our U.S. markets continue to strengthen, despite a moderation in the rate of house price increases, as the double-digit growth experienced in many U.S. markets in 2012 and 2013 was not sustainable. Going forward, we expect to see a more healthy and

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balanced growth rate in home prices that should support absorptions and affordability in the longer term.

We believe the biggest challenge in the U.S. right now is the hesitancy of the first-time buyer to enter the housing market. There are several reasons for this—student debt, slower household formations, lack of down payment, together with a certain fear factor on the part of the younger buyer that real estate doesn't always go up, which was certainly the belief 5 to 10 years ago. The average age of new home buyers has increased significantly as a result. However, we're not concerned in the long run about this issue, because as the cost of rent increases in most markets, home ownership will again become more appealing, especially as that first-time buyer's job situation improves.

Over the last several years, we've continued our focus on bringing lots from a raw state through the approval and entitlement process, which, as I said, is up well for 2014 and beyond. As a result of our efforts, we have increased our number of active housing communities to 56, from 47 at the end of 2013. Our outlook for 2014 and '15 remains positive. Based on current market conditions, we anticipate income before income taxes for 2014 should be measurably higher than in 2013. Given the complexity and timing variability of lot sales, in particular, many of our lot initial closings are projected for the end of 2014 and are subject to the normal timing risk of approvals and the development and closing process. As a result, if they do not close in 2014, we anticipate they will occur early in 2015.

Our land position, with approximately 109,000 lots controlled, provides us with a large and readily developable land portfolio in North America. We are well positioned to gradually increase our homebuilding and land sales activity in the future as the overall market continues to improve.

I'm now going to pass it over to Craig, who will review the financials.

CRAIG LAURIE:

Thank you, Alan, and good morning everyone. As Alan mentioned, our results in the second quarter were strong. Net income increased $18 million to $42 million, or $0.36 per diluted share, in the second quarter, over the second quarter of 2013. Second quarter revenue increased 8% to $321

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million, over the second quarter of 2013 and lot closings increased 26% to 515 units, compared to the second quarter of 2013. The average home selling price increased 31% to $552,000 in the second quarter, compared to $420,000 for the same period in 2013.

The increase of $18 million in net income for the three months ended June 30th, 2014, compared to the same period in 2013, was primarily the result of a $21 million increase in gross margin, which resulted mainly from higher lot closings and higher average home selling prices, combined with an increase in equity earnings from unconsolidated entities of $5 million, and an increase in other income of $2 million due to a one-time asset sale not in land inventory. This was partially offset by higher general and administrative expense of $6 million, an increase in interest expense of $4 million, and an increase in income tax expense of $1 million.

Land revenue totalled $81 million for the three months ended June 30th, 2014, a decrease of $24 million, when compared to the same period in 2013, while gross margin increased $2 million to $43 million over the same period of 2013.

When we look at our operating segments for the three months ended June 30th, 2014, land revenue in Canada was $64 million, a decrease of $35 million, when compared to the same period in 2013. The decrease was primarily the result of a mix of land sold as there was a decrease in raw and partially finished acre sales due to a 216-acre parcel sale in 2013. This was partially offset by five additional single-family lots sold in 2014, when compared to the same period in 2013. Gross margin decreased $2 million to $39 million, when compared to 2013, as a result of the lower raw and partially finished acre sales in 2014, partially offset by the mix of land sold, additional single-family lots sold, and the higher average lot selling price due to improved market conditions.

Land revenue in California for the three months ended June 30th, 2014 increased by $9 million, when compared to the same period in 2013. This was primarily the result of the sale of 94 single-family lots sold in 2014, compared to no land sales in 2013.

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Land revenue in the Central and Eastern U.S. segment increased by $2 million and gross margin remained flat for the three months ended June 30th, 2014. The increase in revenue was due to an increase of eight single-family lots sold, primarily in our Denver market, and increase in average lot selling price related to the mix of lots sold.

In terms of our housing operation, housing revenue was $240 million for the three months ended June 30th, 2014, compared to $193 million for the same period in 2013. The increase was the result of increased average home selling prices in all our operating segments, partially offset by fewer home closings. Gross margin increased $190 million, as the result of a 31% increase in the average selling price, when compared to the same period in 2013, partially offset by a 5% decrease in home closings.

In Canada, housing revenue for the three months ended June 30th, 2014 remained consistent, when compared to the same period in 2013. Total home closings decreased 8% for the three months ended June 30th, 2014, compared to the same period in 2013, due to decreased closings in Alberta as a result of timing. The average home selling price increased 9%, due to price escalation from market conditions in Alberta and from product mix, particularly due to Ontario having a higher proportionate share of the total home closings, as our homes in Ontario have a slightly higher average selling price. As a result of higher average selling prices, gross margin increased by $3 million for the three months ended June 30th, 2014, when compared to the same period in 2013.

In California, we had housing revenue of $118 million for the three months ended June 30th, 2014, an increase of $33 million, when compared to the same period in 2013. The increase in revenue was due to a 64% increase in the average home selling price for the three months ended June 30th, 2014, when compared to the same period in 2013, partially offset by 21 fewer home closings. Gross margin increased $14 million as a result of the increase in average home selling price, which was primarily driven by modest price increases and a product mix of higher priced homes closing in our San Francisco Bay area and Southern California communities for the three months ended June 30th, 2014, when compared to the same period in 2013.

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The Central and Eastern U.S. housing revenue increased $14 million for the three months ended June 30th, 2014, when compared to the same period of 2013, as a result of 18 additional home closings and an increase in the average home selling price. A portion of the increase is a result of the Denver market which had 13 home closings for the three months ended June 30th, 2014, compared to no closings in the same period of 2013. Our Denver operation began in 2013 and did not start having closings until the third quarter of 2013. Gross margin increased by $2 million, when compared to the same period in 2013, due to product mix and higher average selling prices. The increase in the average home selling price is due to the increase in home closings and product mix of the homes closed in different communities across this segment, when compared to 2013.

Our backlog continues to be strong, with a 5% increase in backlog units and a 23% increase in backlog value, when compared to the same quarter of 2013.

Net new home orders for the three months ended June 30th, 2014 were up marginally at 679, versus 665 in the same period of 2013, with improvement in all regions, other than the Central and Eastern, which was impacted by the more measured market in the Washington D.C. area. For the three months ended June 30th, 2014, incentives held flat in all regions, other than Central and Eastern. We saw a marginal increase in Washington, D.C..

Moving to our balance sheet, as at June 30th, 2014 our assets totalled $3.3 billion. Our land and housing inventory and investments in unconsolidated entities are our most significant asset, with a combined book value at $2.8 billion or approximately 84% of our total assets. In the second quarter, the increase in our land and housing assets is attributable to acquisitions of $36 million, development activity and a stronger backlog.

During the quarter, we repurchased for cancellation approximately 540,000 shares of our Common Shares at an average price of $20.11, under our normal course issuer bid. We funded the purchases through our available cash and believe that these purchases are a prudent investment at times when the market price of our common shares may not fully reflect the underlying value of our business and our future business prospects.

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We'd like to thank you for joining us in the quarter-end conference call and I'll now turn the call back to the Operator, who will moderate questions.

OPERATOR:

Thank you. We will now begin the question and answer session. If you would like to ask a question, please press star, and one, on your touchtone phone. You will hear a tone to indicate you're in queue. For participants using a speaker phone, it may be necessary to pick up your handset before pressing any keys. If you wish to remove yourself from the question queue, you may press star, then two. There'll be a brief moment while we poll for questions.

The first question today comes from Bob Wetenhall of RBC Capital Markets. Please go ahead.

BOB WETENHALL:

Good morning, and thanks for all the colour, and congrats on a nice quarter.

ALAN NORRIS:

Thanks Bob.

BOB WETENHALL:

I wanted to get a view—total controlled lot inventory is down 3.5% year-over-year and it looks like you're slowing the pace of net inventory growth a little bit; it was over $200 million in the first quarter of '13 and now it's $125 million. Are you shifting a little bit more towards a divesting phase rather than a position of building up inventory?

ALAN NORRIS:

No, that's a good question. I think, as we've said in some of the past calls, Bob, we are—we don't need the 109,000, obviously, to accomplish what we need to do as a company, but we are trying to be opportunistic. Where monetization opportunities do present themselves, where it's not critical for the business, or there's a value being paid for the lot position that rewards us appropriately for where

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we're at, we will look to do that. So, I think you'll see some initiatives on that over the next 12 to 18 months. I mean, we're working our way through some of those in different markets.

BOB WETENHALL:

Okay. In your core Canada markets, I think, and correct me if I'm wrong, home prices are increasing at a faster pace than lot prices and we were trying to understand whether that's a function of mix between lots and homes, and also your ASPs in Canada are up nearly 10%. Is that indicative of a richer mix shift in what you're selling or is that just strong price momentum in the Calgary market? Thanks and good luck.

ALAN NORRIS:

Thanks Bob. With respect to the lot price increases, obviously, as an absolute percentage, the increased value on the lots is a higher percentage on lots and, therefore, when the house is going up, most of the residuals, it goes into the house, it's a smaller percentage on the house price, just because of the land component is maybe 35% of the ultimate finished house price. So, most of it would be on the land side, which then translate into the same dollar amount probably coming through on the house which is, obviously, a slightly smaller percentage just because of the denominator. I think that's what you're asking. If there's any confusion, don't hesitate to get back to us, but I think that's—I mean, if a lot price goes up $20,000, I mean, that could well be a 10% increase on the lot but obviously, it might only be a 5% increase or a 4% increase on the house.

BOB WETENHALL:

So, that's why we were asking, because it looks like home prices are actually outpacing the growth in the lot prices.

ALAN NORRIS:

On the absolute dollar amount, you mean?

BOB WETENHALL:

On a percentage basis.

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ALAN NORRIS:

Yes. Well, in some cases, there could be some mix in there, as well. I mean, there were a few amenity lots and et cetera, that type of stuff. We can get back on specifics; I don't have it right at the tip of my tongue—but, Craig, did you have anything else?

CRAIG LAURIE:

Yes, I think it's what you both you said, in terms of mix. Obviously, on the house price, as we mentioned, you had a higher component of Ontario, as well, which would drive up the house price, because those are more expensive homes. In terms of the lot, you know, we've had meaningful price increases, obviously, higher price increases out of Calgary, as Alan mentioned, versus Edmonton. So, you know that will depend on the mix between Calgary and Edmonton.

ALAN NORRIS:

On an overall basis, we're obviously very comfortable with where we're at, from a Calgary, Edmonton and Toronto, I mean, from a Canadian perspective; that's the overriding thing. On an apples-to-apples basis, I would say that the direction has been up in all three markets, just to give you that indication.

BOB WETENHALL:

You expect that strong pricing momentum, it sounds like, to continue in 2H, correct?

ALAN NORRIS:

Yes, I mean, I think—I mean, not to maybe necessarily continue on that trajectory as much. I mean, I think, obviously, there's a constrained supply situation in one of the markets which, as we get that resolved, it should bring more moderation to the pricing.

BOB WETENHALL:

Nice quarter. Good luck.

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ALAN NORRIS:

Thank you.

OPERATOR:

The next question comes from Will Randow of Citigroup. Please go ahead.

WILL RANDOW:

Hey, good morning, guys, and congrats on the quarter.

ALAN NORRIS:

Thanks Will.

WILL RANDOW:

In terms of your Canadian land margin, it almost seems like year-on-year acceleration. I'm not sure if it's mix driven, but also California, you know, holding in—or I shouldn't say "holding in," picking up a little bit. How should we think about the pace of land sale margins? I know it can be choppy, as well as the pace of land sales, in the second half of '14?

ALAN NORRIS:

From a Canadian point of view, it should be a fairly steady state, I would say. There's not too much volatility there. I think the only issue, from a California point of view, is it could be, as we've a said in the past, a lot of the stuff in the California is opening up, some new communities, so it's back-end loaded, and it depends on us, literally, getting the service—the entitlements are there. It's just a question of physically getting the infrastructure and the services into the lots, such that as we can accomplish the sale. All of the lots are under contract, for the most part, and it's really just a question of getting it to a finished state. So, that's really the situation in California, I would say.

WILL RANDOW:

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Just on the pace front, I mean, in the first half your land sales have been a bit lower than the first half of last year, for obvious reasons. How should we think about the second half? Should that also be lower all year-on-year?

ALAN NORRIS:

Which area are you talking about, Will?

WILL RANDOW:

Land sales; I apologize.

ALAN NORRIS:

Yes, but a particular region?

WILL RANDOW:

No, just totalled up. I mean, you're running a little bit down year-on-year each quarter in the first half. Should we think about kind of that same down—call it $10 million a quarter to $20 million in the second half each quarter, year-on-year?

CRAIG LAURIE:

Will, this is Craig. I think, in terms of the lot sales, obviously, you know, at the end of last year we gave unit count guidance; we don't update that throughout the year, but I think in terms of Canada lot sales, as we did mention, we are getting marginally better gross margins, but it is a more measured pace. So, yes, we could be—the actual unit count could be off marginally from that original unit count guidance but, as we said, we'd made it up in margin.

In terms of the other regions, it really depends, as Alan mentioned. A lot of those lot sales that we are looking to occur are scheduled to happen very near the end of the year and so, there's always the chance that they could slide.

WILL RANDOW:

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Got it. Just as a follow-up, your Central and Eastern segment in terms of housing gross margins; how much do you think your overhead carry—I believe it's above average—is distorting your gross margin? What do you think the run rate is once those communities are firing up (ph)?

CRAIG LAURIE:

Yes, I think where you—I think you'd see that in Central and Eastern lot sales, in particular, where we're not selling enough yet to really hit the full carry costs. In terms of the housing margin, I'm not sure it's as much impacted. I think, to some extent, that's just a lower margin region.

ALAN NORRIS:

Yes, I mean, and, obviously, on the gross margin, in particular, I mean, obviously, that's pre SG&A, so, from that point of view. I mean, obviously, D.C. is probably a little bit slower, as Craig alluded to through his comments. There's no question that the D.C. market—I think most builders are experiencing a softening in the D.C. market right now, which is from a government perspective and some of the uncertainties surrounding that.

Really, from a Colorado point of view, we're still getting our legs there with respect to our housing initiatives and our housing business. So, we're comfortable we're going to get there, but the one market that's probably that bit softer is the D.C. market, I would suggest, on that front.

WILL RANDOW:

Thanks, guys. I appreciate it.

ALAN NORRIS:

Thanks Will.

OPERATOR:

The next question comes from Sam McGovern of Credit Suisse. Please go ahead.

SAM MCGOVERN:

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Hi, guys. Thanks for taking my questions.

ALAN NORRIS:

Hello Sam.

SAM MCGOVERN:

Sort of continuing on the land sale questions, when you think about sort of the areas of housing that are softening, have you seen any sort of related pull-backs from the builders in terms of demand for land, at this point?

ALAN NORRIS:

Yes, that's a good question, Sam. I'll run through a couple of the regions from a U.S. point of view and just give you the flavour of the month with what's going on. I mean, I would say from a California point of view, I mean, we sold some lots there just at the end of the quarter, for instance, and that was Inland Empire type lots. The communities I was touching on there that we have coming on towards the end of the year, we've got a number of phases that are coming on in those communities in Southern California which are under contract, and we haven't had any real hesitation from the point of view of the builders. They've got earnest money up in most cases, as we speak, finishing off some DD, but we don't see any problems there at this point.

I switch into Austin; again, we've got a couple of communities coming on there. We've got the lots under contract. We're seeing no hesitation with respect to closing on those. Again, it's just a function of getting them serviced, so that we can actually physically close the contracts.

Phoenix, I would say is a tale of a few different stories. I would say in our Eastmark project, we've seen some builders who are continuing to do okay and other builders who are struggling a little bit. So that market, as we've touched on before, has flattened out, because of the significant appreciation last year, but we are seeing some builders who are still being successful and others who have decided to move on.

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So, it's a little bit of a tale of two different types of situations, but we're still on track from what we're planning in the Phoenix market, but there are some guys who are choosing to back off because they think things have flattened out a little bit too much.

SAM MCGOVERN:

Got it. Just on the stock buybacks, you guys are about, I think, a little bit more than a quarter of the way through the normal course issuer bid. How do you think about, you know, whether you want to scale that up over time versus using that money to invest in the business?

ALAN NORRIS:

Yes. I mean, I guess we also look at the buyback as a form of capital allocation. I mean, it's really, obviously, the alternative is to continue to go out there and buy some other assets, but we think—we're obviously buying our own assets at what we believe is a very, very attractive price. We're betwixt and between with respect to the quantum. I mean, we're all well aware of the public float. I mean, we have a major Shareholder who's got about 68% of the Company, with a 32% public float, and, obviously, the more we do on the buyback, obviously, the more we impinge upon the public float.

So, we're trying to strike a healthy balance that shows confidence, because we think it's a tremendous buy. I mean, obviously, when we initiated it, it was a higher stock price than where we are today and, obviously, the returns are even higher at the price we're at, at this point in time, in our opinion. So, we're trying to strike that balance. I mean, obviously, if we increase it, we somewhat inhibit the public float a little bit more, which has other consequences down the road, potentially, for people entering and exiting the stock.

SAM MCGOVERN:

Got it, that's helpful, and then just a housekeeping question. What was total liquidity at the end of the quarter?

ALAN NORRIS:

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Approximately a billion between cash on hand and the various—Craig, correct me if I'm wrong.

CRAIG LAURIE:

No, that's right. Obviously, we still have the cash balance and then we still have the U.S. 250 revolver; we have the Brookfield Asset Management line of 300, and then we have availability on the Canadian line, which is a $500 million line ....

ALAN NORRIS:

Got it. Thanks, guys. I'll pass it on.

ALAN NORRIS:

Thanks, Sam. Cheers.

OPERATOR:

The next question comes from Joey Matthews of Wells Fargo Securities. Please go ahead.

JOEY MATTHEWS:

Hi, guys. How are you doing?

ALAN NORRIS:

Good, thanks.

JOEY MATTHEWS:

So, I wanted to ask first just what you think are some of the major pieces of the Brookfield story that is either misunderstood or overlooked by investors right now? I mean, just looking at your buyback price and where it's trading at now, like, you just alluded to something's amiss and I just wanted to see what your, you know, top two things you think are just driving that gap between Wall Street and your internal idea of what your value proposition is?

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ALAN NORRIS:

I'll just touch on a few. I mean, obviously, we are—we're a little bit more land-heavy than many of the other U.S. companies. Obviously, there's a bit more visibility on pure homebuilding. So, therefore, the visibility into our earnings, as much as we try and be as transparent as possible through our corporate profile and our website and come up with what we think is excellent disclosure, it is a little bit lumpier, obviously, on the land side which is not as predictable to many out there.

As I touched on earlier on the normal course issuer bid, I mean, we do have a 32% public float, which, I mean, when everybody was jumping into the housing sector last year, from a momentum point of view, all it does is, if people do want to exit it, it just makes it a little bit tougher from a liquidity point of view.

But, our story, I mean, we are long land, but we do not have to be out there replenishing. The story is that we are extremely well positioned in Canada and the United States. We've got a great steady state in Canada, which some people don't quite understand but, I mean, I think we've got a 50-year track record, which proves it up, and many can look—we've got nine years of history sitting in our corporate profile and another 41 years before that, where we've proved up how consistent our opportunity is and our business case is up here in Canada.

But, I think, from a U.S. point of view, we're still getting to the point where if we wanted to do close to 500 homes in each of our markets—I mean, we've got 11 markets; we're only doing about 2,500 homes. We can easily be doubling the number of units there and we can be also dealing with lot absorptions and selling off to others, and show that more mature state, which we are not yet at. So, it's understanding that we are going to get to that point, where we will be absorbing 6,000 to 10,000 units either through lot sales or housing occupancies, or whatever and showing a significant amount of cash flow in earnings as we go forward, and it's really understanding and looking at what our track record is.

I get it, from the last three years, since we've been a merged company, candidly, the first 15 months, there wasn't much to talk about; land truly was that four-letter word that nobody wanted to talk about.

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Then the next 15 to 18 months was a very good positive story with respect to the U.S. recovery, and now it's paused somewhat, but we're not really that concerned on the pause because, candidly, if the market had continued at the pace it was going at in the back half of '12 and into '13, there would be a lot of concerns with respect to that pace of increases.

So, we're okay. We think that the recovery will continue, but at a much more measured pace and people, such as ourselves, will be a significant beneficiary of that, as we move up our housing activity and our monetization activity through other lot sales to third-party builders who are actively still trying to feed their pipeline. Many of their peers out there are looking to us to supply lots to them as we go forward and we already have the land, we have it entitled in many cases, we just have to service it and bring it to the marketplace.

SAM MCGOVERN:

All right, thanks for that. Next question more near term; how should we think about orders for community in California going forward? This recent quarter, there was a significant decline. I don't know if maybe you could help us understand what drove that decline, if it was more of a demand-related issue with the buyer, if it's you have less attractive communities that are online now versus a year ago, or if it's a higher price mix issue so, more of an explanation for the decline in the most recent quarter, as well as how we should benchmark it going forward.

ALAN NORRIS:

Yes. I'll deal with your second point. Our communities are extremely attractive, so just to make that point. But no, I think our price point has climbed a fair bit in California. As a result, you maybe don't quite see the absorptions per community as high. I mean, we're selling $900,000 homes. You don't necessarily get to that level from an absorption point of view, the higher price point. You're getting a little bit more into niche in some cases and it's not necessary a direction that we're going consciously. It just happens to fit the particular land assets and communities that we're bringing on at this point in the—not so much in the cycle, but the land assets that we have currently.

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I mean, I think we will, obviously, be striving to deal with a more balanced and maybe—not say more affordable, but on a general direction, we think affordability, we want to try and continue to address that, but some of the land assets and the communities we're bringing on just now are meeting a need in the marketplace, but they just happen to be a higher priced product at this point in time.

So, I'm not concerned about it. I mean, we'll get some great margins coming through. Obviously, I mean, we're still making north of 20% in many of those cases, from a gross margin perspective, on $900,000 homes.

SAM MCGOVERN:

Great. Thank you.

ALAN NORRIS:

Thank you.

OPERATOR:

As a reminder, if you would like to ask a question, please press star, then one, on your touchtone phone.

Our next question comes from Andrew Feinman of Iridian Asset Management. Please go ahead.

ANDREW FEINMAN:

Thank you. I saw you guys in New York in May and bought some stock for our clients and so at the moment we have a loss. The story was very compelling, because of the, you know, your inventory of properties that you owned with kind of a built-in 25% gross margin, because you bought them well and not too much need for replenishment. So, you know, I guess I'm wondering if it's visible yet when we might see a return of capital or is that even the wrong to look at it. Are you really planning to use the

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capital to build more houses, so what I should be looking for is growth in earnings and not necessarily cash coming into my pocket through a dividend.

ALAN NORRIS:

Yes, I mean, I think—thanks for the question. As I touched on a little bit earlier, I mean, for instance, the stock buyback initiative is just one leg of a capital allocation approach that we would look at. I mean, we would look to try and balance—I think we would like to increase our housing presence in many of our markets, so that will require some additional investment, but that just gets us to a good critical mass in each of the markets where we currently do business. So, that will require some of our capital that way, but we would be looking to monetize some—selling some other lots and things of that nature and I really think we would be taking a balanced approach with respect to capital.

The idea of repatriating capital is always one of the considerations, as we go through different cycles, and I'm not saying we're at that point at this point, but, generally speaking, we will generate a significant amount of cash over time and we just have to balance off the opportunities that exist in the marketplace and obviously, anything to do from a share initiative. We're not a company which is going to, nor have we ever been, where we have to grow for growth's sake. I mean, we've very focused from the point of view of enhancing value for Shareholders and we will take whatever the appropriate measures are in order to do that, whether it be on stock buybacks or whether it be through earnings power, or whatever; we'll be looking at the appropriate returns in all cases.

ANDREW FEINMAN:

Well, I appreciate that and I'm also—I like everything you're doing, but the stock buyback so far, your number of shares still up year-over-year, so that hasn't actually helped me as a residual owner in terms of the value of my holdings, and the earnings… .

ALAN NORRIS:

Yes, the only thing I can think of in that one is that there was a small conversion of some of our old preferred, but I mean, we've bought, as we reported, over 500,000 through the end of the quarter.

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We've continued to buy on a consistent basis every day since then, because of the value that we're seeing in the marketplace.

ANDREW FEINMAN:

So, in the past, you've paid special dividends from time-to-time. So, I guess, and you mentioned that when you were in New York in May. Can you see an opportunity for that to occur sometime in the, you know, investible time horizon; special or regular?

ALAN NORRIS:

I mean, as I said earlier on, I think we have to look at what opportunities are out there and if we feel that the best opportunity is to repatriate money to Shareholders, as opposed to continuing to invest in the business, we would take the appropriate action and try and find some way to address that. I'm not going to get into whether that's on the cards at this point in time. I mean, we're still—candidly, I still think we're in the early innings of the U.S. housing recovery at this point and I think there is a fair bit of room to grow, to be quite honest.

So, I'm not say I'm doubling down, but I'm just saying that I think there's many opportunities out there in the marketplace, as well. We'll approach it from a balanced point of view to try and come up with the right mix for the Company and, obviously, its Shareholders.

ANDREW FEINMAN:

Okay. Well, I thank you very much for that. The last thing I'll just say, it seems, with the thin float getting thinner, if earnings go up, it's not clear that the market will necessarily give me a return, you know, give your stock a fair valuation on those earnings, without them being accompanied by free cash flow that is somehow making its way back to your owners.

ALAN NORRIS:

I appreciate the insights.

OPERATOR:

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The next question comes from David Spier of Nitor Capital. Please go ahead.

DAVID SPIER:

Hey, how are you guys? Great quarter.

ALAN NORRIS:

Thank you.

CRAIG LAURIE:

Thank you.

DAVID SPIER:

Listen, I don't want to beat a dead horse here, but on the buyback, it seems like you guys repurchased around $10 million worth of shares. On our analysis, which obviously could be wrong, but it seems that the market is valuing your land at a severe discount here to anything that would be available on the open market. So therefore, wouldn't it, more or less, make the most sense to place the primary focus on buying back your own shares rather than taking cash out of the Company via a dividend, as previously mentioned, or buying more land? I know when you mentioned it's a small float and there's liquidity issues, especially with aggressively buying back shares, but you even mentioned that your shares still represent compelling value here. So, more or less, what I'm getting at is how do you go about bridging this gap for Shareholders and at the same time, also taking advantage of the opportunity that's in front of you?

ALAN NORRIS:

Yes, I mean, it's a fine balance, there's no question about it, David. We tried to find that balance on the 2 million share number that we picked, again, to try and protect the public float somewhat, as well as to show that we think it's a very good investment… .

DAVID SPIER:

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More or less, what I'm getting at, is if you have the ability to buy back your own shares and you're buying land at a severe discount at anything that is available, but at the same time you're afraid of, you know, causing liquidity issues, will you go out and buy land on the open market at a higher—at a premium, instead of hurting your liquidity, more or less. That's kind of what I'm getting at.

ALAN NORRIS:

No, we're not going buy land just for the sake of buying land because we don't want to hurt the float, no.

DAVID SPIER:

Got it, okay.

ALAN NORRIS:

I mean, we'll do the right thing with respect to—I mean, we've still got the same criteria as we've always had with respect to when we're purchasing assets, and we need to make certain returns. I understand your point, but we're not going to do something just because… .

DAVID SPIER:

That's good to hear. From everything you guys have done so far, it seems that would be the case, so I appreciate…

ALAN NORRIS:

We have a discipline as to how we're approaching it, yes.

CRAIG LAURIE:

The only other thing I would add, that we have talked about in the past, is—you know, the other thing we're obviously balanced against is developing our land in order to advance it for monetization. While our acquisitions in the quarter certainly have gone down, you are seeing our dollars that are being spent to develop the land to advance it…

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DAVID SPIER:

Yes, that makes sense. The land doesn't develop itself, so that makes sense.

CRAIG LAURIE:

Yes, exactly.

DAVID SPIER:

The other question—and the last one, I'll leave it be—but looking at the longer term here and ignoring some of the more short-sighted metrics that a lot of the analysts seem to focus on, I think it's worth mentioning that—you mentioned that you're land-heavy and that's the reason for the discount, but being land heavy is, in our minds, actually a positive, considering it's a significantly higher margin business.

ALAN NORRIS:

Yes.

DAVID SPIER:

At the same time, it seems like, on our numbers, you guys are selling lots at about $130,000 to $140,000 per lot. Historically, you guys are generating around 40% plus margins, around $55,000 per lot, but if you look at your share price, the market seems to value your 109,000 lots at under $20,000 per lot. So, that's a pretty significant discount that we're more or less referring to, you know, between the real value you guys are generating, about $55,000, and the implied value of the shares, which is around $20,000. So, I hope that's realized by all.

ALAN NORRIS:

Yes, I mean, I think we've tried to disclose in the profile, as you know, David, the—I mean, from a raw land point of view, you can see the book value of our raw land and we've tried to explain what we will net out of that raw land on a future cash flow point of view on an undiscounted basis, which is in excess of $5.5 billion. So, we've tried to give that visibility and that doesn't have any inflation or any of

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those things into it, and that does not include any housing on top of that, either. So, I appreciate your point and that's why we're trying to be as transparent as possible.

DAVID SPIER:

All right, I appreciate it and looking forward to seeing you guys bridge that gap and getting that unit price to reflect the accurate value. I appreciate it.

ALAN NORRIS:

I appreciate it. Thanks, David.

OPERATOR:

We have a follow-up question from Will Randow of Citigroup. Please go ahead.

WILL RANDOW:

Hey, thanks for taking my follow-up, I have a little bit of a short-sighted question. In regards to community count growth in the second half, are you still looking, on the housing side, mid-50s and how does that ramp over the next two years?

CRAIG LAURIE:

Will, it's Craig. In terms of—yes, I think our original guidance was roughly community count of about 57, including JVs, I think we're at 56, so that would be about a net one in the latter half of the year. In terms of the next two years, I'm not sure we're in a position to give that right now.

WILL RANDOW:

Do you think its mid-single-digit or greater than that, growth year-on-year?

ALAN NORRIS:

We're, literally, working our way through different nuances a bit. As I said earlier on, Will, just about increasing the housing activity in some of the regions. So, until we go through some of the pros and

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cons, I just don't want to be sort of misleading until we've really got our head around exactly how much we're going to be doing ourselves versus selling to others.

WILL RANDOW:

Okay. Thanks for taking my follow-up and congrats again.

ALAN NORRIS:

Thanks Will.

OPERATOR:

The next question comes from Frank Mayer of Vision Capital. Please go ahead.

FRANK MAYER:

Good morning, everybody.

ALAN NORRIS:

Good morning, Frank.

FRANK MAYER:

It seems to me that one of the problems that Brookfield is experiencing is that the Quarterly Report only reports on earnings, per se, which is on dispositions, sales of houses and sales of land. During this period; during the three months and during the six months of 2014, fiscal 2014, the Company has created considerable value, both through the appreciation of land in its marketplace and through the processing of land which enhances its value as it becomes entitled lots and annexed land within cities, etc.

So, the question I have for Management is could you give us some idea of what that unreported number might be; the appreciation of value that has occurred to the benefit of individual Shareholders during the first six months of the year?

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I noticed that, in that regard, that of course, Al, you mentioned a reference to $5.5 billion of undiscounted ash flow. I think these numbers are only revised once a year and that would, presumably, pick that up. If you're not prepared to give us a dollar amount for the first six months, could you give us some idea as to what the trend in the $5.5 billion might be and where that number might stand at year end?

ALAN NORRIS:

Yes, it's obviously difficult to try and value the appreciation. That's just part of what we do every day, Frank, obviously, to try and bring it through the process, to add the value. I totally get your point with respect to the unrealized gain that we get from the other 90,000 lots that we're continuing to take through the process.

The $5.5 billion, I just want to make sure we're all clear. Obviously, we will be moving land from raw into a developed state so as we go through—if everything stayed static and prices are increasing, you'd continue to see that number go up. We will obviously be pulling some numbers out of the $5.5 billion as we bring it through to the developed state. So, I think what is incumbent upon us to do is to try and explain, as we update that once a year, as to what has moved from raw into developed and you'll see that corresponding change there. It's either going to be crystalized through sales or it's going to end up in our land under development.

But, you're exactly right. I mean, we are experiencing some price increases in some of the markets which is one aspect of value creation as we continue to hold land, which will go up in value because of that and we continue to get value creation through taking a particular piece of land from an unentitled state to an entitled, or further progressing it. So, there's a combination of ways of doing that. We tried to explain in the profile which ones are entitled, what stage they're at, things of that nature, and there's enough maps, et cetera, there to try and explain—people will be able to understand in some of the markets what that should result in. But, it's difficult to do an unrealized gain calculation on a quarter-by-quarter basis, because there's a lot of moving parts, but I get your point.

FRANK MAYER:

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I mean, let's start at the base case. Is it fair to say that the $5.5 billion has not gone down?

ALAN NORRIS:

We don't update it until we do it at the end of the year. I mean, as we take—as I said, what I can't recall is exactly how much we've—we've approved a lot of land, taking it out of raw and into a developed states. I mean, we've done like close to—you know, a number of project approvals through the course of the year, which continues to develop it, so, I mean, we're bringing more lots on, and as we touched on a little bit earlier in the call, is we haven't quite replenished all of it, nor do we have to. I mean, our lot count is down slightly, but I mean, we're still in a very, very solid state. All I'm saying is there will be some that come out. I mean, we could be taking out 300/400 acres' worth of land, easily, in some of the regions there, to move it into a developed state which comes out to $5.5 billion, but brings it much closer to crystallization.

It's not a very positive story. So, I mean, we will update it and try and bring clarity to it, as to what's gone in and what's come out, so that you can get a more apples-to-apples version when you see it. If that was number was 5.6—I'm just picking a number, Frank—it could well be that we took out what used to be $600 million worth of raw land out of that $5.5 billion number and so the net increase is there, but the rest of it is coming through land under, so just to try and show the movement.

FRANK MAYER:

Mm-hmm. I mean, how many years have you been doing this $5.5 billion number now?

ALAN NORRIS:

I think just since the merger; just over three years ago.

FRANK MAYER:

What has the pace of increase in the number been over those three-and-a-half years? I mean, what did it start off at?

CRAIG LAURIE:

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Frank, its Craig. I think we referenced it within the profile, the exact movements year-over-year, and as Alan said, there's a lot of moving parts. I mean, other examples would be if we decided to monetize something in a raw or partially-finished state that, arguably, could bring down the number, but would be a very positive thing, and I think Alan referenced that…

FRANK MAYER:

I mean, I'm just trying to get at what has the historic increase been in that number over the last three years.

CRAIG LAURIE:

I think it's moved from 4.7 to 5, 5.5.

ALAN NORRIS:

I'm going off the top, Frank. I think it was at 4.7, then 5, and now 5.5.

FRANK MAYER:

So, I mean, is there anything to suggest that that progression would not continue?

ALAN NORRIS:

Other than we'll be trying to advance and monetize and do things and create—I mean, obviously, the quicker we advance some of the monetization, the more value we have for the Company. So, that's the whole point. So, I mean, this is all undiscounted, no inflation, but if we advance the timing of the cash recovered, that allows us to either reinvest or deal with other capital allocation; things that we touched on earlier. So, it's—we're very comfortable with where we're at, let's put it that way.

FRANK MAYER:

Thank you very much.

ALAN NORRIS:

Thanks, Frank.

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OPERATOR:

Your last question comes from Rick Murray of Midwest Advisors. Please go ahead.

RICK MURRAY:

Hi, good morning, gentlemen.

ALAN NORRIS:

Good morning.

RICK MURRAY:

Just a quick question; I apologize, I got on the call late, so you may have already covered this, but related to the pace of absorption in California, it seems like there's been a bit of a dramatic slowing. Are there any other sort of timing or other issues related to community openings, or anything like that?

ALAN NORRIS:

Yes, Rick, it's Alan here. Yes, we did touch on it a little bit earlier on, but, really, just to clarify. I mean, our price points have gone up quite significantly in California, for a lot of good reasons, but just from a pace point of view, typically, on the higher end homes, it will be a slightly lower pace, so I think it's just a mix thing at this point. We're not too concerned, we're still achieving our margins and our results, but as we get closer to that $900,000 price point, which I'm not saying is going to be replicated forever, but at this point, with the types of land that we have and the communities we have, we are going after some of that higher price point and the absorptions will be a touch slow just because of the cost.

RICK MURRAY:

Okay, I appreciate that, and then just a final comment. I may be old or old-fashioned, but being in the land development business six years into a housing cycle, I'd be very comfortable holding onto the liquidity.

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ALAN NORRIS:

Yes. Yes, I understand. We're sitting with just about a billion dollars of liquidity at this point, so we're in very good shape with respect to that. Our debt profile is 2020, 2022, from the point of view of our unsecured notes. I still believe that the pause that we've seen from a US housing recovery point of view, we touched on earlier on in the call, I'm not saying it's going to prolong it forever, but I still think we're in—we're not in the late innings of a recovery by any stretch, in my opinion, from a U.S. point of view. So, I think there's still some room to go, but we still have—we're trying to come up with a balanced approach with respect to reinvestment, increasing our footprint in the areas where we do business, and looking at capital allocation for Shareholder definite initiatives, such as the buyback. So, we're trying to take balanced approach to it.

RICK MURRAY:

Okay, I appreciate that. Thank you.

ALAN NORRIS:

Thank you.

OPERATOR:

There are no further questions. I will now hand the call back over to Alan Norris for closing comments.

ALAN NORRIS:

Thanks, Brock. Thanks, everybody, for taking the time out of your busy day to listen to our call. I appreciate your support and your insight, and we look forward to talking to you at the end of Q3. Thank you.

OPERATOR:

This concludes today's conference call. You may now disconnect your lines. Thank you for participating and have a pleasant day.

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