Brookfield Residential Properties, Inc.
2014 Fourth Quarter Results
Conference Call Transcript

Date: Wednesday, February 11, 2015

Time: 11:00 AM ET

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, Mr. Norris.

ALAN NORRIS:

Thank you very much. Good morning, ladies and gentlemen, and thank you for joining us for Brookfield Residential's 2014 Year End 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 within the meaning of applicable Canadian and U.S. securities laws. These statements reflect predictions of future events and trends and do not relate to historical events, are subject to known and unknown risks, and future events may differ materially from such statements. For more information on these risks and their potential impact on our Company, please see our filings with securities regulators in Canada and the US and information available on our website.

Let's begin by addressing the bid for the largest shareholder, Brookfield Asset Management Inc., to acquire the approximately 30.6% of our shares that it does not already own for a cash consideration of $24.25 per common share. A special meeting of Brookfield Residential shareholders is scheduled for March 10, 2015, to consider and vote on the arrangement. The Brookfield Residential Board of Directors has recommended that shareholders of Brookfield Residential approve the arrangement. Shareholders are urged to carefully review the Management Information Circular and accompanying materials that were mailed to shareholders and are available on SEDAR at www.sedar.com; on EDGAR at www.sec.gov, and on Brookfield Residential's website. Assuming shareholder approval is received and customary closing conditions are met, it is currently expected that the closing of the arrangement will be completed prior to the end of March 2015. Obviously we will be respecting the process and any updates on this process that are required to be press released are being done.

Turning over to our operations, in 2014 we delivered excellent performance. Our income before income tax increased 56% to $269 million compared with $172 million during the same period in 2013. The improvement was due to improved housing and land gross margin percentages as our overall gross margin percentage for the year ended December 31st, 2014, increased to 30% from 28% in 2013. Net income for the year ended December 31st, 2014 was $274 million or $2.33 per diluted share compared with $142 million or $1.21 per diluted share in 2013. Included in net income was a release of the valuation allowance on our U.S. deferred tax assets which resulted in a recovery of income taxes of $45 million in the third quarter of 2014.

In 2014, we also increased our active housing community count to 61 at the end of 2014 from 47 at the end of 2013 as we brought a number of new projects to market in both the U.S. and Canada. Our net new home orders also increased to 2,382 units and this in turn increased both the number of units in our backlog and the total backlog value to 1,005 and $497 million, respectively.

We also expanded our portfolio of well-located land assets with the completion of $224 million of strategic fund acquisitions during 2014. At year end, we controlled approximately 106,000 lots.

These results and achievements continue to reinforce our long-term approach to the business of securing assets in growth markets, adding value to our land through the entitlement process and then realizing that value during appropriate times in the housing market cycle.

This year we were able to deliver strong performance amidst uneven market conditions, particularly in the U.S. While the housing market recovery continued in 2014, it was at a measured and sometimes bumpy pace. Credit and mortgage qualification challenges, lagging household formations and continued trepidation amongst first-time home buyers contributed to a continuation of historically low levels of home ownership on a national basis, however, the recent announcement related to changes in lending standards and the proposed reduction in FHA premiums will address some of those concerns. In addition, the specific geographic markets we operate in fared better with demand remaining healthy in most of our markets.

In Canada, the economy remains stable with a low inflation rate and a continuance of the low interest rate environment. Our presence in the Alberta and Ontario markets position us in two of the country's strongest real estate markets, contributing to solid income and cash flow from our Canadian operations. While we do recognize that the recent decline in oil prices may have a significant impact on Alberta's economy, as new oil and gas projects are deferred and hiring freezes go into effect, we believe consumers in our other Canadian and U.S. markets are viewing the oil price drop as a tax cut. This could ultimately help to stimulate home buying in those markets.

I'll now pass the call to Craig to speak to our financial results.

CRAIG LAURIE:

Thank you, Alan, and good morning everyone. As Alan outlined, Brookfield Residential had strong results in 2014. Net income attributable to Brookfield Residential for the 12 months ended December 31st, 2014, was $274 million or $2.33 per diluted share, an increase of $132 million over the $142 million or $1.21 per diluted share for the same period in 2013.

The increase in net income for the 12 months ended December 31st, 2014, was partially the result of an increase in the income tax recovery of $30 million which was mainly due to a reversal of the valuation allowance on our U.S. deferred tax assets in the third quarter of 2014. Additionally, there was a $70 million increase in gross margin, primarily from improved housing margins, an increase in equity earnings from unconsolidated entities of $17 million, an increase in other income of $10 million, a gain on sale of commercial assets of $33 million, and a decrease in other income and consolidated subsidiaries of $5 million. This was partially offset by higher general and administrative expense of $17 million, an increase in interest expense of $11 million, an increase in sales and marketing costs of $1 million and a decrease in the change of fair value of the equity swap of $4 million.

Land revenue totalled $340 million for the year ended December 31st, 2014, a decrease of $33 million when compared to the same period in 2013, and land gross margin decreased $1 million to $172 million.

The decrease in land revenue and gross margin for the year ended December 31st, 2014, was due to 295 fewer single family lot closings and 216 fewer raw and partially finished acre closings. This was partially offset by an increase in the gross margin percentage resulting from higher average single family lot selling prices, higher raw and partially finished acre selling prices and from profit participation revenue collected.

Our land revenue may vary significantly from period to period due to the nature and timing of land sales. Revenues are also affected by local product mix and market conditions which have an impact on the selling price per lot.

When we look at our operating segments for the year ended December 31st, 2014, land revenue in Canada for the year ended December 31st, 2014 was $270 million, a decrease of $29 million when compared to the same period in 2013. The decrease was a result of the mix of lot land sold with 216 fewer raw and partially finished acre parcel closings being sold in 2014 when compared to the same period in 2013, partially offset by 84 additional single family lots sold.

Gross margin decreased $4 million to $154 million when compared to 2013, primarily as a result of lower raw and partially finished acre sales and lower average selling prices for multifamily, industrial and commercial acre sales in 2014.

The lower average per acre selling price for multifamily, industrial and commercial is due to the mix of land sold, where most of these multifamily acre parcels have lower average selling prices in general when compared to commercial parcels.

Land revenue in California for the year ended December 31st, 2014, was $13 million, a decrease of $20 million when compared to the same period in 2013. This was primarily the result of a decrease of 264 single family lots sold in 2014 compared to 2013, partially offset by an increase in the average lot selling price and profit participation revenue collected on past land sales.

For the year ended December 31st, 2014, revenue in the Central and Eastern U.S. segment increased by $16 million to $57 million and gross margin increased by $6 million to $9 million. This was due to an increase in average lot selling prices related to the mix of lots sold in different communities across the segment, partially offset by 115 fewer lot closings when compared to the same period in 2013.

Housing revenue and gross margin were $1.1 billion and $273 million, respectively, for the year ended December 31st, 2014, compared to $983 million and $202 million for the same period in 2013. The increase was a result of a 16% increase in the average home selling price due to both price escalation and the mix of homes closed, partially offset by a 1% decrease in home closings when compared to the same period in 2013.

In Canada, housing revenue for the year ended December 31st, 2014 increased $27 million to $499 million when compared to the same period in 2013. This resulted from 58 additional home closings and a slight increase in the average home selling price for the year ended December 31st, 2014, compared to the same period in 2013. The increase in the average home selling price was attributable to price escalation, primarily in the Calgary market, as a result of market conditions and product mix between segments. As a result of increased closings and a higher average selling price, gross margin increased by $15 million to $113 million for the year ended December 31st, 2014, when compared to the same period in 2013.

Our California segment had housing revenue of $488 million for the year ended December 31st, 2014, an increase of $118 million when compared to the same period in 2013. The increase in revenue was due to a 48% increase in the average home selling price for the year ended December 31st, 2014, compared to the same period in 2013, partially offset by 56 fewer home closings.

Gross margin increased $56 million when compared to the same period in 2013 as a result of the increase in the average home selling price, which was partially—primarily driven by product mix where a large portion of homes closed in 2014 were higher priced homes with selling prices over $1 million from our San Francisco Bay area and Southern California communities for the year ended December 31st, 2014.

The Central and Eastern U.S. housing revenue increased $8 million to $149 million for the year ended December 31st, 2014, when compared to the same period of 2013, as a result of an increase in the average home selling price, partially offset by 14 fewer home closings. The decline in closings was due to 49 fewer home closings in the Washington, DC market, partially offset by an increase in closings in the Denver market which had 53 home closings for the year ended December 31st, 2014, compared to 18 closings in the same period in 2013.

Our Denver housing operations began in 2013 but did not start having closings until the third quarter of 2013. Gross margin remained consistent at $23 million when compared to the same period in 2013 due to product mix and higher selling prices offset by fewer closings. The increase in the average home selling price is due to the product mix of homes closed at different communities across the segment when compared to 2013.

As at December 31st, 2014, the backlog of housing units including our share of unconsolidated entities increased 10% to 1,005 units, while backlog value increased 11% to $497 million when compared to December 31st, 2013.

Moving to our balance sheet, our assets as of December 31st, 2014, totalled $3.4 billion. Our land and housing inventory and investments in unconsolidated entities are our most significant assets with a combined book value of $2.8 billion or approximately 82% of our total assets.

Land and housing assets increased when compared to December 31st, 2013, due to acquisitions of $224 million, development activity and stronger backlog, partially offset by sales activity.

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:

Thank you and 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 speakerphone, 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 and two. There will be a brief moment while we poll for questions.

The first question is from Sam McGovern with Credit Suisse. Please go ahead.

SAM MCGOVERN:

Thanks for taking my questions. Just on the Canada market and your comments, and I apologize if you guys discussed this earlier; I just hopped on the call a little later than I had hoped initially. Have you guys actually seen any slowdown in the Alberta markets or, you know, is it just sort of the expectation, and can you talk a little bit about how you see that sort of playing out over time?

ALAN NORRIS:

Yes, good morning, Sam. It's Alan here. Yes, definitely with the volatility in the oil prices, listings have increased in the Calgary market by a significant amount, just over the, shall I say the Christmas period. I think, just giving some indication even just the early part of the year, there could be an issue with consumer confidence. I mean there's a lot of talk about it, but candidly, our sales in the early part of the year are somewhat on track, albeit we've incentivized a little bit more on some of the single family product, but not really much on our multifamily for sale product. So, there's no question I think it would be naïve of us to think there's not going to be an impact with this. Volatility in oil prices is so great, most of the companies are obviously deferring some projects and so it's a bit of a lag effect, but nothing significant at this point. We've seen some of these ups and downs before in that marketplace so we're not too concerned, but obviously it's more an issue of consumer confidence than anything else.

SAM MCGOVERN:

Got it, and then in the Ontario market with the lower or weaker Canadian currency relative to the dollar and some other currencies, have you seen any impact from that in terms of foreign investors perhaps either accelerating or sort of maintaining their purchasing in that market?

ALAN NORRIS:

Yes, I'm not sure we can anecdotally speak to any additional foreign investors. I'll talk to Ontario mostly on the FX side. It is like a bit of a tax cut with respect to oil pricing and obviously the FX will help the Ontario export market. So, generally, we're seeing nothing negative at all; in fact more positive, I would say, in Ontario markets.

SAM MCGOVERN:

Got it, and in terms of 2015 overall, what are you guys thinking in terms of land and development spending and how that rolls out versus 2014?

ALAN NORRIS:

I think we've been on a path with respect to increasing our emphasis on building up our housing business, and you can see that in our housing WIP, we continue to increase our community count, so we'll continue to be doing that from a U.S. perspective; I would say that the Canadian one is still relatively stable with respect to that, subject to the volatility of oil prices and what I just touched on.

SAM MCGOVERN:

Okay, great. So the mix and mix in community counts shifts towards the U.S., away from Canada, is that right?

ALAN NORRIS:

Not away from Canada but just we continue to build our business in the U.S. That's really the extent of it. We're not declining anything in Canada. We're really just increasing our position in most of our existing markets in the U.S.

SAM MCGOVERN:

Got it. Understood. Great, thank you guys and I'll pass it along.

ALAN NORRIS:

Great. Thanks, Sam.

OPERATOR:

As a reminder, if you wish to ask a question, please press star and one on your touchtone phone. The next question is from Joe Matthews with Wells Fargo Securities. Please go ahead.

JOEY MATTHEWS:

Hi. I have a question on your gross margins this quarter and going forward. You look like you performed a little better than some of your other public peers this quarter, seeing a nice gain year-over-year. Some of your peers, however, are expecting some moderation or even a decline in 2015 and I was wondering if you have the same sentiment towards your future gross margins.

CRAIG LAURIE:

Sure. Hi Joey, this is Craig.

CRAIG LAURIE:

I couldn't comment on all of '15. I could tell you that our current gross margin percentage that's in our backlog is consistent at about the 24% that we averaged for 2014. So certainly on the sales that we have to date, we are consistent.

JOEY MATTHEWS:

Okay. Then just looking back over the past year, your single family lot closings in your U.S. markets is well below kind of what you've guided to initially and I was wondering if that's a timing issue or if there were delays developing those lots and getting them delivered to your builder customers, or how should we think about that? Is it that you wanted to hold onto them and just get a better return over the longer term?

ALAN NORRIS:

It's a good question, Joey. No, for the most part it was really just a question of getting them to that finished serviced state that allowed us to transfer them as finished lots to our customers, so mostly for the most part it's really just a timing issue. I mean there was two of them, two tranches done in Southern California and another group of lots in Austin, Texas, and to sum up, it was really just a question of slight delays in approvals, but the rest of it was mostly just physically getting the servicing done to get them to that finished state that allowed us to convey them as finished lots to our customers. So it's mostly a timing issue I would suggest.

JOEY MATTHEWS:

Great, thank you.

ALAN NORRIS:

Thanks very much.

OPERATOR:

There are no more questions at this time. I'll now hand the call back over to Mr. Norris for closing comments.

ALAN NORRIS:

Thank you. Yes, we wanted to thank you for joining us today on the call. If the going private transaction occurs, this may be our last call with you and we want to thank you for your support. If you indeed acquired your shares at the time of our March 31st, 2011 merger at a price of $10 per share, you will have realized an annualized return of approximately 25% on your investment, so we are extremely pleased that your confidence in us was rewarded. So thanks again and stay tuned with respect to the ongoing updates with respect to the going private transaction with a scheduled shareholder meeting for March 10th, 2015. So, thank you once again.

OPERATOR:

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