Brookfield Residential Properties, Inc.

2014 Third Quarter Results

Conference Call Transcript

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

Craig Laurie
Executive Vice-President and 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. Good morning, ladies and gentlemen, and thank you for joining us today for Brookfield Residential's 2014 Third 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 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 U.S. and information available on our website.

Also, as many on the call would have read about at the time, on October 23rd, 2014, Brookfield Asset Management announced that it had made a proposal to the Company to acquire the approximately 30% of the common shares of Brookfield Residential that it does not already own for $23 cash per share. The Board of Directors of Brookfield Residential has established a special committee of independent directors to review and consider the proposal, and the Company will provide an update at the appropriate time. As a result, I do ask that everyone respect this process and understand, as a result, we will not be commenting on the process or views on value today.

We're going to switch up the order today and I'm now going to pass it over to Craig, who will review the financials. Then I'll provide an update on the market and our strategy before opening the call to questions.

CRAIG LAURIE:

Thank you, Alan, and good morning, everyone. Building on our progress from the first six months of 2014, we continued to achieve positive results in the third quarter of 2014.

Net income attributable to Brookfield Residential for the three months ended September 30th, 2014, was $86 million or $0.73 per diluted share compared with $35 million or $0.29 per diluted share in the third quarter of 2013. Included in net income was the partial release of the valuation allowance on our U.S. deferred tax assets, which resulted in a benefit for income taxes of $45 million for the third quarter of 2014. We expect that the remaining valuation allowance pertaining to our U.S. operations will be released against income before income taxes in the last quarter of 2014.

Income before income taxes increased to $48 million from $45 million in the third quarter of 2013. Third quarter revenue increased 7% to $355 million and the average home selling price increased 19% to $516,000 in the third quarter compared to $432,000 during the same period in 2013. This was partially offset by higher general and administrative expense of $2 million, an increase in interest expense of $2 million, a decrease in other income of $2 million, and a decrease in the fair value of the equity swap of $5 million.

Land revenue totalled $64 million for the three months ended September 30th, 2014, a decrease of $7 million when compared to the same period of 2013, while gross margin decreased $5 million to $36 million over the same period in 2013. The decrease in land revenue is primarily due to 95 fewer lot closings, partially offset by higher average lot selling prices when compared to the same period in 2013. The decrease in gross margin for the three months ended September 30th, 2014, was due to the mix of land sold, where there were fewer lot sales and a decrease in the average selling price for multi-family, commercial, and industrial acres, partially offset by higher single-family average lot selling prices when compared to the same period.

When we look at our operating segments for the three months ended September 30th, 2014, land revenue in Canada was $58 million, a decrease of $4 million when compared to the same period in 2013. The decrease was primarily the result of the decrease in the average selling price for multi-family, industrial, and commercial acres due to the mix of parcels sold, where there was a higher proportion of the acres sold in the Edmonton market which typically have a lower average selling price and gross margin. Single-family lot revenue was consistent as a result of 46 additional lot closings, partially offset by a decrease in the average selling price due to mix of lots sold as our Edmonton operations had a higher proportions of lots sold when compared to the same period in 2013.

Gross margin decreased $5 million to $35 million when compared to 2013, as a result of lower average single-family lot selling prices and the lower average multi-family, industrial, and commercial acre selling prices, primarily due to product mix. There were no land sales in California for the three months ended September 30th, 2014. Land revenue in the Central and Eastern U.S. segment decreased by $3 million, and gross margin remained flat for the three months ended September 30th, 2014. The decrease in revenue was due to a decrease of 141 single-family lots sold, primarily as a result of a bulk sale of 128 lots in our Denver market in 2013. There has been no such sales to date in 2014. This was partially offset by an increase in the average lot selling price related to the mix of lots sold, as the D.C. market had a higher proportion of sales.

In terms of our housing operation, housing revenue was $291 million for the three months ended September 30th compared to $262 million for the same period in 2013. The increase was a result of increased average home selling prices, partially offset by fewer home closings. Gross margin increased $13 million as a result of 19% increase in the average selling price when compared to the same period in 2013, partially offset by a 7% decrease in home closings.

In Canada, housing revenue for the three months ended September 30th, 2014 decreased $8 million when compared to the same period in 2013. Total home closings decreased 3% for the three months ended September 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 decreased slightly due to product mix, particularly due to a higher proportionate share of the total home closings from Edmonton, where we have slightly lower average selling prices. As a result of lower average selling price and closing, gross margin decreased by $3 million for the three months ended September 30th, 2014, when compared to the same period in 2013.

In California, we had housing revenue of $141 million for the three months ended September 30th, 2014, an increase of $50 million when compared to the same period in 2013. The increase in revenue was due to a 62% increase in the average home selling price for the three months ended September 30th, 2014, compared to the same period in 2013, partially offset by five fewer home closings. Gross margin increased $17 million as a result of the increase in the average home selling price when compared to the same period in 2013, which was primarily driven by product mix of higher priced homes closed, with the average home selling price of $1 million and above in some of our San Francisco Bay area and Southern California communities for the three months ended September 30th, 2014.

The Central and Eastern U.S. housing revenue decreased $13 million for the three months ended September 30th, 2014, when compared to the same period of 2013 as a result of 25 fewer home closings and a decrease in the average home selling price. The decrease in home closings was primarily the result of fewer closings in the Washington D.C. market. Gross margin decreased by $1 million when compared to the same period in 2013, due to the decreased home closings, combined with the lower average selling prices. The decrease in the average home selling price was due to product mix of homes closed in different communities across the segment when compared to 2013.

Our backlog continues to be strong, with a 3% increase in backlog unit and a 10% increase in backlog value when compared to the same quarter 2013.

Moving to our balance sheet, as at September 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 of $2.8 billion or approximately 84% of our total assets. In the third quarter, the increase in our land and housing assets is attributable to acquisitions of $168 million, development activity and a stronger backlog, partially offset by sales activity.

I'll now pass the call back to Alan.

ALAN NORRIS:

Thanks, Craig. Beginning with the market overview, I think we've touched on this in the past that, in our opinion, the significant price appreciation that we experienced in most U.S. housing markets in 2012 and early 2013 was reflective of a limited supply of housing being taken up by both investors and consumers. We also believe that the trajectory of the price increases over that period of time was unsustainable and prices have since generally reverted back to a more normal growth curve.

We believe several other factors have given rise to the current pause in the marketplace: slower household formation, lack of mortgage availability, weakness in the overall quality of jobs being created, and the degree of trepidation on the part of the first time home buyer, which in our view are all contributing to the current state of the market. We also believe that, generally, it takes longer than one expects to achieve an economic recovery in a sector which has undergone significant duress. The positive side of the current state of the market is a result in pent-up demand that continues to build as families double up or stay in accommodations long after they're no longer meeting their growing families' needs. It is our belief that this represents substantial unfilled demand. It's expected that as rents rise and the job situation improves, home ownership will again become much more attractive.

Specific to our Canadian markets, while concerns persist regarding the high rise market in Vancouver and Toronto, the general concern for a bubble in the Canadian housing sector seems to have subsided, with proactive efforts by the Canadian government to address household debt showing positive signs. Our Alberta markets have continued to show strength. While prices for both oil and natural gas have faced downward pressure, technology advances and other initiatives have somewhat offset some of these pressures to drive those industries forward. We also continue to believe that North America's energy needs can be served from North America and that this will ultimately be positive for Alberta in particular. Calgary, Alberta has experienced strong demand this year, which, combined with limited supply, has resulted in price escalation. We've made great strides in three of our longer-term land projects—Bearspaw, Livingston, and South Seton—on the approval front and to ensure appropriate continuity, we are maintaining a disciplined release of lots until further entitlements of our new projects are received.

Over the last several years, our strategy has focused on bringing lots in both our U.S. and Canadian markets from a raw state through the approval and entitlement process. As a result of our efforts, we have a strong overall land inventory, with almost half our lots entitled. This is a key competitive advantage given the constrained supply of development ready lots in many of our U.S. and Canadian markets and one that gives us flexibility to bring product to market at the right time.

We also continue to focus on the pace of monetization of our lot portfolio, which, at the current pace, would represent over a 15-year supply. Assuming the ongoing recovery in the U.S., we expect to reduce our land supply over the next number of years, targeting an eight to 10-year supply of land. This will be achieved by advancing the value of our land and, in some cases, strategically selling once entitlement is achieved. One example of this includes the monetization of a significant portion of one of our joint ventures which we entered into in the third quarter of 2013 in the community of Tegavah, located in Phoenix, Arizona. In the past year, the land was entitled and reengineered and, subsequent to the third quarter of 2014, was sold for a gain, with our share totalling approximately $10 million.

Another key focus going forward is to increase our housing business across the board. While we will be selling still a majority of our lots to third party builders, we intend to get all 11 of our business groups to 400 to 500 home closings per year. This includes Denver, where we just started our housing operation a year ago; Austin, where we are currently starting up a new housing operation; and Phoenix, where we don’t yet have a housing operation. While we believe there will be continued demand for Greenfield development, we have made moves to reposition a portion of our portfolio to infill and Brownfield developments to better respond to the growing segment of the market seeking these locations and lifestyle. Projects such as our Playa Vista development in Los Angeles, California and Midtown in Denver, Colorado are great examples of success in these types of projects.

Our outlook for the year remains positive. As has occurred in many past years, we anticipate that our income before taxes for the 2014 fiscal year will be somewhat back-end loaded. Based on current forecasts and subject to timing risk and FX in the form of currency, we project fourth quarter income before income taxes will be at levels equalling to or approaching the income before taxes for the entire first nine months of this year, resulting in the 2014 fiscal year results being significantly higher than 2013.

We welcome you to join us on November 18th and 19th for our first Investor Day at Playa Vista in Los Angeles. Details on this event can be found on our website. As noted earlier, we ask everyone respect and understand that we will not be commenting on the proposal from Brookfield Asset Management at this time.

I'd like to thank you for joining us on this conference call. I'll now turn it back to the Operator, who will moderate the questions.

OPERATOR:

Thank you. The first question today is from Will Randow of Citi. Please go ahead.

SCOTT SCHRIER:

Hi, good morning. This is Scott Schrier in for Will today. I wanted to talk about both your community count growth and your use of incentives, and I saw that you have very limited incentives outside of the Eastern and Central U.S., where you're at 8%, and taking into account a lower absorption rate, I just wanted to see how are you looking at using incentives going forward versus the current rate that you have?

ALAN NORRIS:

Was that specific to the Eastern region? You were asking the question…

SCOTT SCHRIER:

Well just in general. I saw there was 8% in the Eastern region and then I don't think you used any or barely in Canada and California.

ALAN NORRIS:

Yeah, there's not—there's very few with respect to—in Canada, we're sort of eking out the product, just matching up with—as I say, in the Calgary marketplace, we're matching it up with when the entitlements are coming through for our future projects, so there's no need with respect to incentives there. Very little in the way in Toronto, and California, there may be some—I'm just talking off the top here with respect to where they're taking place, but there may be some in the inland Empire side of things but really not too much. I apologize for not giving a more straightforward answer. I'm just—It it hasn't really been a big topic with respect to—from a business point of view.

SCOTT SCHRIER:

Sure, no, that's helpful. Then on the gross margin side of things, given that the mix has changed to lower ASP kind of housing, is there any impact to gross margin, or is the gross margin in the quarter that something that's somewhat sustainable?

CRAIG LAURIE:

Yes, this is Craig. Are you referring to Alberta, where we're seeing more homes that are closing?

SCOTT SCHRIER:

Yeah, if I just look at the ASP and backlog as a whole.

CRAIG LAURIE:

Yeah, so, I think, Canada is almost segment-by-segment, the average ASP within California was up materially, that was product mix, and gross margin has been up there. In Toronto, I would say that average ASP is consistent. This is the sort of thing we have talked about, a higher proportion of the total closings, home closings in Alberta coming from Edmonton, and that is a lower average ASP. It probably does have a slightly lower gross margin, but it's not as defined as the difference in gross margin between lot sales between Calgary and Edmonton.

SCOTT SCHRIER:

Okay, great. Thank you for taking my questions.

OPERATOR:

The next question is from Alex Avery with CIBC. Please go ahead.

ALEX AVERY:

Thank you. Alan, in your opening remarks, you mentioned that you're focused on the monetization and that your existing land inventory would represent about 15 years of supply at your current pace. I just want to be clear about how you're measuring that. Is that the number of home closings and lot closings, or home closings or lot closings?

ALAN NORRIS:

Yeah, it would be a combination, Alex. I mean, in Alberta, we're maybe doing 20%, 25% of housing on our own and selling the balance, and in other markets, it may be closer to 46%, those types of things, but the absorption that we're talking to get into that eight to 10-year supply, would be for the underlying land whether we build on it ourselves or others had.

ALEX AVERY:

So when you say that you're targeting getting down to about eight or 10 years of supply, that still could take several years from now?

ALAN NORRIS:

Yeah, we think we can probably get there over the next several years. we've as an example, we've listed a property in Calgary that we think —that we have—that has added some value. and so—there's other ones. I mean, the Phoenix example was one where we achieved some value through re-entitlement and re-engineering and we exited a fair bit of the joint venture in October of this year, so that was another example of just creating the value then monetizing at the appropriate time. So there'll be a number of those across the portfolio at some point over the next several years.

ALEX AVERY:

Okay. I'm trying to get a sense of the pace of monetization. Is it accelerating, has it accelerated, or are you planning to accelerate it?

ALAN NORRIS:

Yeah, it will be—from our own—as I touched on through the remarks as well, we intend to—I mean, from a housing point of view, we would anticipate being north of 5,000 homes a year because we'll be building in most of our communities. That will take several years to get to that point and we would anticipate that we would be probably 5,000 to 6,000 lots a year around about that same timeframe, so that would be getting us up to north of 10,000 units a year that we will be monetizing and in one way—either through housing or through lots.

ALEX AVERY:

Okay, so the homebuilding wouldn't eat into your lot sale numbers; it would be in addition to?

ALAN NORRIS:

That's what we believe, yes, that's correct.

ALEX AVERY:

Okay, okay, that's very helpful. Then just in terms of, I guess, the strategy of bringing your inventory down to eight to 10 years that would bring you — or it would seem to bring you more in line with some of your U.S. homebuilder peers. You talked about, you know, when you can do that and the fact that you have that objective. Can you talk about why that's an objective?

ALAN NORRIS:

Well, I mean, I think there's a couple of points. One, I think, we would be looking to monetize some assets when we've created value, but we will redeploy some of that money back into other projects. We may have a project which has, for instance, 2,000 units in a Greenfield area, as an example, and we create value, we may monetize that position, but we may reinvest that money from that project, as an example, into 500 units in an infill or Brownfield situation. So we may be investing the same amount of capital but just into different product types, and the unit count may, in fact, be less because of location and pricing. We're not reducing the size of the business. I think it's just a refocus on some of the other areas at the same time, the net count in that example would obviously go down but the business would remain strong.

ALEX AVERY:

Okay. Then, Craig, just on the tax recovery—or reversal of the, I guess, the tax valuation in Q4, what is the amount roughly that you're expecting there?

CRAIG LAURIE:

We expect the remainder, which is approximately $25 million to come through in Q4.

ALEX AVERY:

Okay. Then just lastly, not getting into any of the details, but on the proposal from BAM, just to be clear, there hasn't been a formal proposal, there are no written details. At this point, is it expected that you'll see something from Brookfield, or is the ball in the special committee's court to assess, you know, a proposed proposal? Is that clear?

ALAN NORRIS:

Yeah, I mean we—on October 23—as we said in the original press release, Alex, we received a letter from Brookfield Asset Management and we're also creating a special committee of the Board to review the proposal and take the appropriate steps.

ALEX AVERY:

But there's been nothing more substantial than the letter delivered at this point.

ALAN NORRIS:

Yeah. I mean, everything would be dealt with by the special committee.

ALEX AVERY:

Yeah, okay. Then just roughly speaking, you know, you can never nail it down, but should investors expect anything in 2014, or is this going to take more than the next 45 days?

ALAN NORRIS:

Craig, any thoughts on that one?

CRAIG LAURIE:

I think, certainly, the special committee is, you know, working actively through the process. I don't think you'll see a completion of the process necessarily within '14. Obviously, there's a lot to it, but I think you'll continue to see the special committee be quite active working through it within '14.

ALEX AVERY:

Okay, that's great. Thanks for the colour.

ALAN NORRIS:

Thanks, Alex.

OPERATOR:

Your next question is from Bob Wetenhall with RBC Capital Markets. Please go ahead.

BOB WETENHALL:

Hey, guys, good morning.

ALAN NORRIS:

Morning, Bob.

BOB WETENHALL:

I was just curious, what are your thoughts on average selling prices in the markets where you operate, and is it really the trajectory of ASP that's influencing your decision to shorten your land supply or how do we think about the motive? Because it does sound a little bit like you and Craig are changing or pivoting from a strategic standpoint; being long land, you got a great asset base, you're shortening it up. What's the right rationale to think about that?

ALAN NORRIS:

Yeah, I mean, I don't think we're just taking a view with respect to, if we have an asset that we think is outside of maybe that eight, some markets, we will be little bit longer than others, Bob. I mean, there's some where we'll be little bit shorter. That eight to 10 is maybe just a generic average, I would suggest. But as I touched on, on the earlier comment, we're just looking to, you know, shift some of our emphasis not necessarily just on the next Greenfield piece, which has been very successful for us and we will continue to be the dominant part of our business, without question.

We will refocus some other areas to look where we think the consumer is going, which would be some other closer in locations, many of those are higher value assets, re-entitlement assets, mixed-used Brownfield and those types of things. So what it does is it allows to reposition ourselves while not in any way, shape or form, damaging the trademark of what we are, which is long land and then continuing to monetize through housing and third party lot sales. So I don't want it to be taken as anything other than it allows us to do other things as well and not damage the existing business that we currently have.

CRAIG LAURIE:

Sorry, Bob, this is Craig. I'd just add to what Alan said. I'm sort of reiterating the point that he made in his initial comment. You know, the sort of straightforward math is we absorb, between homes and lots, 5,000 to 6,000 units currently; let's say roughly half of that is housing. In our minds, an efficient level of housing for each one of our "11 business groups" would be 300 to 500, so if you do the straightforward math just on that, I mean that's obviously—you know, that can be 4,000 to 5,000 homes up from roughly 2,500. The same thing on the lots; if you just increase it by 1,000 or 2,000 you also increase that to 5,000. So instead of absorbing 5,000 to 6,000 units, you're absorbing 10,000 which, again just mathematically, if the lot count did not change at all, dividing by 10,000 units brings you down to 10 years.

So as Alan said, I don't think it's a material change. I think, to some extent, it's just reaching an efficient level of homebuilding in each of the markets that we are either currently operating in or looking to do homebuilding in.

BOB WETENHALL:

So it sounds like—based on Alan's comments, it's really just complementary initiatives to extend on the core land business. Would that be a fair assessment?

ALAN NORRIS:

Yeah, I think that's fair, absolutely. I mean, we're not changing our stripes.

BOB WETENHALL:

Okay. You got a really good balance sheet. Just trying to get a view from a growth standpoint because you're going to shrinking the balance sheet, but you don't have—you know, your leverage is fine, your cash is strong. Is there anything you want to buy, and what do you think about M&A opportunities today?

ALAN NORRIS:

Yeah, I mean I'm not sure we're shrinking the balance sheet. As I said, we're redeploying some of that into other built forms or potential, so I don't think there's a shrinking there. Our balance sheet, as you quite rightly said, Bob, is in excellent shape and it gives us—and we're sitting with about a billion dollars of dry powder from a liquidity point of view at the end of September, which has been consistent for the last number of quarters. If we saw something that made some sense, everybody on the call is aware that we did look at a couple of opportunities in the past and we didn't go forward on those and others bought them, and if the right opportunity comes along and we think it's an additive, I mean, we are looking to move into housing in some of the other markets where we don't have housing, but those are not, I would say, big potential. We either will start from the ground up or look at some operations in those particular markets or enhance what we have but nothing on a major scale at this point.

BOB WETENHALL:

Got it, so you're just going to be selectively opportunistic. My comment was that if you go from having a 15 or 20-year land position at current absorption and then you want to get down to a 10, doesn't that mean your carried inventory position is going to get smaller?

ALAN NORRIS:

Yeah, but again, as Craig touched on, I mean, we're increasing our volume at the same time, so instead of taking it from 5,000, 6,000 absorptions a year between land and housing, I mean we gradually get up to 10,000 plus. I mean, we can move from 110,000 lots down to 100,000 or 90,000 or whatever, and I mean a combination of coming down a little bit, as well as the absorptions going up, gets us to that steady state and a redeployment of the cash into some of these other high value asset opportunities sort of rebalances that portfolio. So I think it's a combination of some of those factors and—I mean, our business will grow, there's no question in my mind.

BOB WETENHALL:

I see what you're doing and that make sense. Final question, any big developments on specific parcels heading into the fourth quarter, whether it's up in Calgary or Playa Vista? Thanks and good luck.

ALAN NORRIS:

Thanks, Bob. We Yeah, I mean we have a number of, you know, typical—as we said earlier on, a lot of stuff is back-end loaded with respect to people. Some builders buying lots at the end of the year, ready for next year's spring selling season. We've got a few things happening in Q4, as we've touched on before. Some will happen in Q4, some will happen early first quarter of 2015, but I think we're maintaining—we believe most of the stuff that we said was going to happen should be happening and such that maybe where we down a little bit on unit count, but we see higher margins in both the land side and housing side. So we're still maintaining that, in the last quarter, we'll be close to what we have achieved for the first nine months in total, so all in all, we're quite comfortable where we're at.

OPERATOR:

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

SAM MCGOVERN:

Hey, guys, for taking my questions.

ALAN NORRIS:

Morning, Sam.

SAM MCGOVERN:

I was hoping you guys could talk a little bit about what you're seeing in terms of demand, just in the last, you know, month or two with energy prices coming off in some of the regions that you guys operate?

ALAN NORRIS:

Yeah, Sam, it's Alan. I'll talk about it from a Calgary and Edmonton point of view, which is obviously energy-centric. We have, as we've touched on in the past, very much a constrained supply situation, especially in the Calgary marketplace, so we've seen significant price escalation going on in that market, so it's difficult to tell anything affecting from an energy point of view in the last month or so. There's probably been more issues with price escalation going on and there's probably been a little bit sticker shock in the Calgary marketplace as to consumers just sort of saying, "Well, wait a minute. That house I looked at before is now up $25,000 since I looked six months ago," you know, those types of things.

So it's too early to tell on the overall energy side as it affects Alberta. I mean, obviously, we're just talking the spot price for oil and many of the projects up north have got significant sunk cost into the major projects, and so on an incremental—on the marginal dollars going in, even at $77, it's still a significant pickup for all of the companies. I mean, new projects, yes, I mean but nothing's been said in that regard. I think, realistically for most of the other markets, I mean, cheaper oil is going to end up being positive from an overall consumer point of view. So I'm not too, too concerned about it at this point based on where we're at, and I haven't heard anything from my oil and gas friends just as to any major projects being put on hold, and as I touched on before, it's just the incremental dollars. Once the sunk cost is in there for those mega projects, there's still lots of room on a marginal dollar basis.

SAM MCGOVERN:

Great. Thanks so much. I'll pass it along.

ALAN NORRIS:

Thanks.

OPERATOR:

Your next question is from Adam Rudiger of Wells Fargo Securities. Please go ahead.

ADAM RUDIGER:

Hi, thank you. I wanted just to ask about lot sales expected in the fourth quarter relative to previous guidance. You had early in the year given unit count, and if—so, A, can you comment on where you are relative to that; and then B, talk about what you think the margin impact will be on land sales because I guess that guidance would point to a very, very sharp acceleration in U.S. land sales?

CRAIG LAURIE:

Hi, Adam, this is Craig. So as you mentioned, we do not have a practice of updating the unit count guidance. At same time, I'm certainly happy to comment. I think, you know, in totality, the overall unit count expectation for '14 will be less than we originally anticipated, but I think that's being offset obviously by a higher gross margin than we had anticipated. Specific to the lot count, I think the Canadian lots are going to be marginally down for all the reasons we talked about, but certainly that gross margin percent is up. If you went to California, I think the lot count is expected to be, again, marginally down and same with Central and Eastern. The one where I believe we will be roughly consistent, if not outperform, is probably the expectation for the joint ventures with the sale that we announced as a subsequent event.

ADAM RUDIGER:

Okay. I guess what I was trying to triangulate is can you comment at all what the combined company land gross margin should be in the fourth quarter, directionally at least?

CRAIG LAURIE:

Don't think I could at this time. I mean, I think in terms of housing, we would expect that gross margin for the fourth quarter's relatively consistent with the third quarter. In terms of lots, as you said, it depends on the ultimate mix. I think in totality, it should be less than the third quarter just because the lot sales in the U.S. generally have a lower gross margin than we do in Alberta and we didn't have any lot sales in California in the third quarter, had fewer lot closings in Central and Eastern, so we are expecting some lot closings from both California and Central and Eastern in the fourth quarter. So in totality, the combined gross margin for lots should be down some.

ADAM RUDIGER:

Got it, thank you. Then the second question was related to the BAM proposal, and I don't know if I'm starting to wander into areas you don't want to ask or not, but obviously, there's lots of reasons why a company would or would not want to be acquired; one of them's valuation. I understand you don't want to talk about that. My question was though, as the committee evaluates the proposal, are there other—what are the other considerations aside from valuation that might—they might discuss? Alan, specifically, is there a significant benefit to your operations to being a publicly-listed company as opposed to being under their umbrella that would play into the decision?

ALAN NORRIS:

We're not going to comment with respect to how they're going to look at what types of valuations, Adam. That would be obviously under the purview of the special committee and their advisors, et cetera. As to public versus private, as to operations, the business is the business. Whether there's 1,000 shareholders or one shareholder, I mean, our business is developing communities and building houses and making money, and so obviously, it takes one additional thing -- if this does go ahead and it takes one extra level of work, shall we say, but dealing with it, for instance, this type of call, but we still have $1.1 billion of capital in the capital markets on the bond side, so we shouldn't lose sight of that. But again, it's all under the purview of the special committee so they will continue the process.

ADAM RUDIGER:

So is the special committee's effort mostly focused on what the appropriate value, if there is one, on determining that? Is that what they're trying to determine?

ALAN NORRIS:

They are following the process with respect to the proposal that's been made.

ADAM RUDIGER:

Okay. Thank you.

OPERATOR:

The next question is from Chris Keller with Columbia Management. Please go ahead.

CHRIS KELLER:

Yeah, good morning, guys, and thanks for taking the questions. I just had a couple. So we saw kind of a continuation of trends in some of your markets regarding absorptions being lower year-over-year. But in particular, I wanted to ask about what specifically you're seeing going on in kind of your Canadian homebuilding operations. Does it look like orders there were kind of down 16% year-over-year? I realize you had kind of a tough comp but is there anything changed in that market, or is there anything that I'm missing there?

ALAN NORRIS:

Yeah, Chris, it's Alan. I think touching on a little bit of my earlier comment, I think a combination of things. As we are continuing to get entitlements in, say, our Calgary marketplace, we have been very disciplined in releasing lots and housing into the marketplace to try and match up with when we think the entitlements for the future projects will be coming on and when we will be on, so we have that good continuity from one to another. So we have been eking out the lots to try and match up that absorption, and it is a constrained supply market and so the idea we've been eking out to our own homebuilding operation as well, because, candidly, by selling out a lot of lots all at one time in an escalating price environment, we are just passing on that potential profit to others. So we've been trying to match that up as best we can and ease that out.

As I touched on earlier, I think the prices have gone up quite substantially, and I think the consumer is looking and, you know, it takes them a little bit of time to adjust to the new pricing reality. So we've seen a little bit of that taking place but nothing that is concerning us, but we've been trying to slow things down a little bit just to match up with the entitlements, but all in a positive way.

CHRIS KELLER:

Okay. Then I guess, just to maybe clarify then, so is this level of absorption, how long do you think it's going to take for you to kind of get from a supply/demand dynamic where you want, or I guess, how many quarters should we think about this level of absorption being kind of run rate?

ALAN NORRIS:

Yeah, no, that's an excellent point. The only market where we're really experiencing that constrained supply situation as it affects that is Calgary. I mean, Edmonton is continuing to increase volumes. I would say in the Calgary situation, we are hopeful that one of our projects that I mentioned this morning would be bringing on somewhere in the next year to 18 months, that the first of those longer-term projects would be coming on, and then we'd be going sequentially for some of those other new projects shortly thereafter. So it's only over that sort of period of time.

CHRIS KELLER:

Okay. Then I guess, in California, I'm just kind of curious, from a homebuilding perspective, how you guys view this kind of pace of activity this year; relative to your expectations, how it has been? Then how should we also think about kind of the ASPs of this market going forward, they've seen a significant jump year-over-year from, like, 686,000 to like 1.1 million, what's kind of realistic going forward?

CRAIG LAURIE:

So this is Craig. You're exactly right. It's a big part of that would have been the additional contribution from the Bay area. As you said, the averages sale price is obviously, you know, well over a million dollars, and that's certainly driving it. The other portion of it is in Southern California within projects like Playa Vista that also has been driving that average sales price. As we go forward, I think, sort of say two things. To some extent we will still have those homes that are selling over a million dollars, but at the same time, you know, certainly we're always mindful of overall affordability and, you know, intentionally, we want to have a mix of product, not just homes over a million dollars. We want to have homes within the more affordable range as well. So I think in totality, you will eventually see that average sales price will fall but volumes would then go up at the same time.

CHRIS KELLER:

Okay. Just general commentary on U.S. land markets, have you guys seen any change in appetite from the builders, just overall thoughts there?

ALAN NORRIS:

I think it's a good point. We have a number of projects where we have builders who have committed to buy lots which will take place this quarter, some will take place in early 2015. I think, for the most part, builders are still wanting to tie up lots in good areas and in good communities. If they were previously maybe going to be tying up, say, 200 lots, they might try and say, "We only want to pick up 120 or so but we'd like to still have optionality on the other 80," and I'm just giving a generic example that if they feel absorptions are going to be similar or almost slightly better in '15, that they might still want to maybe structure the deal a little bit, so over a longer period of time as opposed to all cash on the takedown.

But the one thing I would say is I still believe that as the pent-up demand gets released, I mean, over the next several years, I think there's a good story on the upside as we go forward, and I think we are well positioned to take advantage of that with the different communities that we have such that we have ready to go if the absorptions do improve over where builders are expecting them just now.

CHRIS KELLER:

Okay, thanks. Then I guess, just one last one for me to follow up on that comment. Any other geographies in which you guys operate that are better or, I guess, materially better or worse from your perspective, any areas of strength or weakness that you'd like to highlight?

ALAN NORRIS:

Canada's still doing extremely well. I think we've talked about the Phoenix market being somewhat volatile. I mean, it was the deepest hit during the recession and probably a very sharp recovery, and it's definitely been somewhat flat since then. But I mean, again as we touched on, I mean, we executed an excellent transaction with respect to that Tegavah joint venture that we touched on earlier on that closed in October. I think the D.C. market's been somewhat choppy, and not just for us but for many others as well. But other than that, I mean our Austin market is doing extremely well and we're launching new communities there and there's great job creation. So it's—I'm not saying a mixed bag, but it's definitely—the strength of the U.S. market right now is obviously much coastal, as well as where the jobs are being created, without question, and that includes sort of the Texas markets and coastal California, and as I say, D.C. has been probably a little bit choppy at this point.

CHRIS KELLER:

Okay. Thank you very much, guys.

ALAN NORRIS:

Thank you.

OPERATOR:

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

ALAN NORRIS:

Thanks very much, Operator, appreciate that. Thank you very much indeed, everyone, for joining us today. Again, apologies we can't talk with respect to the process; that's an obvious. We are still planning to host the Investor Day but, obviously, we will be respectful of that same position at the Investor Day, but if anybody is participating in a couple of weeks of time with respect to that, we will look forward to seeing you and look forward to chatting with you in the New Year. Thanks very much.

OPERATOR:

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