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D R Horton (DHI) Earnings Report: Q1 2016 Conference Call Transcript

The following D R Horton conference call took place on January 25, 2016, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Jessica Hansen; D R Horton; Investor Relations
- David Auld; D R Horton; President & CEO
- Bill Wheat; D R Horton; CFO
- Mike Murray; D R Horton; COO

Other Participants

- Nishu Sood; Deutsche Bank; Analyst
- Stephen East; Evercore ISI; Analyst
- Stephen Kim; Barclays Capital; Analyst
- Alan Ratner; Zelman; Analyst
- Eric Bosshard; Cleveland Research Company; Analyst
- Mike Rehaut; JP Morgan; Analyst
- Ken Zener; KeyBanc; Analyst
- Bob Wetenhall; RBC; Analyst
- Jay McCanless; Sterne Agee CRT; Analyst
- Mike Dahl; Credit Suisse; Analyst
- Will Randow; Citigroup; Analyst
- John Lovallo; BofA Merrill Lynch; Analyst
- Susan Maklari; UBS; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the first-quarter 2016 earnings conference call for D.R. Horton , America's Builder, the largest builder in the United States.

(Operator Instructions)

As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Jessica Hansen, Vice President of Investor Relations for D.R. Horton . Please go ahead, Jessica.

Jessica Hansen (Investor Relations):

Thank you, Operator. Good morning. Welcome to our call to discuss our results for the first quarter of FY16.

Before we get started, today's call may include comments that constitute forward-looking statements, as defined by the Private Securities Litigation Reform Act of 1995. Although D.R. Horton believes any such statements are based on reasonable assumptions, there is no assurance that actual outcomes will not be

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materially different. All forward-looking statements are based upon information available to D.R. Horton on the date of this conference call, and D.R. Horton does not undertake any obligation to publicly update or revise any forward-looking statements. Additional information about issues that could lead to material changes in performance is contained in D.R. Horton's annual report on Form 10-K, which is filed with the Securities and Exchange Commission.

For your convenience, this morning's earnings release can be found on our website at investor.drhorton.com, and we plan to file our 10-Q in the next few days. After the conclusion of the call, we will post updated supplementary and historical data to our Investor Relations site on the presentation section, under news and events, for your reference. The supplementary information includes historical data on gross margins, changes in active selling communities, product mix, and our mortgage operations.

Now I will turn the call over to David Auld, our President and CEO.

David Auld (President & CEO):

Thank you, Jessica, and good morning. In addition to Jessica, I am pleased to be joined on this call by Mike Murray, our Executive Vice President and Chief Operating Officer, and Bill Wheat, our Executive Vice President and Chief Financial Officer.

Our D.R. Horton team started the year with a strong first quarter, setting us up for a great 2016. Our consolidated pre-tax income increased to $241 million on $2.4 billion of revenue, and our pre-tax operating margin improved 40 basis points to 10%. Our homes sold increased 9%, compared to the first quarter of last year, due to improved absorptions.

These results reflect the solid performance of our core D.R. Horton communities, and our Emerald Homes and Express Homes brands. We are striving to be the leading builder in each of our markets, and to expand our industry-leading market share. We plan to maintain consistent, broad product diversity with our three brands over the long term.

Our continued strategic focus is to produce double-digit annual growth in both our revenue and pre-tax profits, while generating positive cash flows and increasing our returns. With a sales backlog of 10,665 homes at the end of December, positive sales trends in January, and a well-stocked supply of land, lots and homes, we are well positioned for the spring selling season and for 2016.

Bill?

Bill Wheat (CFO):

Net income for the first quarter increased 11% to $158 million or $0.42 per diluted share, compared to $143 million or $0.39 per diluted share in the year ago quarter. Our consolidated pre-tax income increased 9% to $241 million in the first quarter, compared to $221 million in the year ago quarter. And homebuilding pre-tax income increased 11% to $229 million, compared to $206 million in the prior year quarter.

Our first-quarter home sales revenues increased 4% to $2.3 billion on 8,061 homes closed, up from $2.2 billion on 7,973 homes closed in the year ago quarter. Our average closing price for the quarter was $290,400, up 3% compared to the prior year, due to an increase in our average sales price per square foot.

This quarter, entry-level homes marketed under our Express Homes brand accounted for 22% of homes closed, and 15% of home sales revenue. Our homes for higher-end move-up and luxury buyers, priced greater than $500,000, accounted for 7% of our homes closed, and 16% of our home sales revenue.

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Mike?

Mike Murray (COO):

The value of our net sales orders in the first quarter increased 12% from the year ago quarter to $2.4 billion, and homes sold increased 9% to 8,064 homes on a relatively flat active selling community count. Our average sales price on net sales orders in the first quarter increased 3% to $293,700. The cancellation rate for the first quarter was 23%, down from 24% in the year ago quarter.

The value of our backlog increased 16% from a year ago to $3.2 billion, with an average sales price per home of $297,600, and homes in backlog increased 15% to 10,665 homes. Our backlog conversion rate for the first quarter was 76%, within the range we guided to on our fourth-quarter call. We expect our second-quarter backlog conversion rate to be in the range of 82% to 85%.

Bill?

Bill Wheat (CFO):

Our gross profit margin on home sales revenue in the first quarter was 19.9%, consistent with the fourth quarter, and up 10 basis points from the first quarter of last year. The consistency in our gross margin reflects the stability of most of our markets today. We are raising prices or reducing incentives when possible in communities where we are achieving our target absorptions, and we are also working to control cost increases.

Our general gross margin expectations remain unchanged. In the current housing market, we continue to expect our average home sales gross margin to generally be around 20%, with quarterly fluctuations that may range from 19% to 21%, due to product and geographic mix, and the relative impact of warranty and interest costs. As a reminder, our reported gross margins include all of our interest costs.

David?

David Auld (President & CEO):

In the first quarter, homebuilding SG&A expense was $243 million, compared to $238 million in the prior year quarter. As a percentage of homebuilding revenues, SG&A improved 30 basis points to 10.3%, compared to 10.6% in the prior year quarter, as our revenue increase improved our leverage of fixed overhead costs. We remain focused on controlling our SG&A, while ensuring that our infrastructure adequately supports our current and expected growth.

Jessica?

Jessica Hansen (Investor Relations):

Financial services pre-tax income in the first quarter was $12.3 million, compared to $14.6 million in the year ago quarter. 90% of our mortgage company's loan originations during the quarter related to homes closed by our homebuilding operations, and our mortgage company handled the financing for 51% of our home buyers.

FHA and VA loans accounted for 50% of the mortgage company's volume, compared to 42% in the year ago quarter. Borrowers originating loans with our mortgage company this quarter had an average FICO score of 714, and an average loan-to-value ratio of 89%. First-time home buyers represented 43% of the closings handled by our mortgage company, compared to 40% in the first quarter last year.

Mike?

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Mike Murray (COO):

At the end of December, we had 21,500 homes in inventory, of which 1,600 were models. 11,300 of our total homes were spec homes, with 7,700 in various stages of construction and 3,600 completed. Our construction in progress and finished homes inventory increased by $291 million during the quarter, as we prepare for seasonally higher demand in the spring.

Our first-quarter investments in lots, land and development totaled $627 million, an increase of 11% from the first quarter of last year. $365 million was to replenish finished lots and land, and $262 million was for land development. We expect that our investments in land and development for the full year of 2016 will be at least 20% greater than FY15.

David?

David Auld (President & CEO):

At December 31, 2015, our portfolio consisted of 178,000 lots, of which 117,000 are owned, and 61,000 are controlled through option contracts, which represents a 10% increase in our option position since year end. 69,000 of our total lots are finished, of which 33,000 are owned, and 36,000 are optioned. Our 178,000 total lots owned and controlled provide us a strong competitive advantage in the current housing market, with a sufficient lot supply to support solid growth in sales and closings in future periods.

Although our housing inventories will fluctuate as we manage each of our communities to optimize returns, we expect our land and lot inventory to remain relatively stable to slightly higher in 2016, which will result in positive cash flows. In the first quarter, we used $1.5 million of operating cash, an improvement of $128 million compared to the first three months of last year.

Mike?

Mike Murray (COO):

During the first quarter, we reported $1.5 million in land option charges [to provide us with] earnest money deposits and due diligence costs for projects that we do not intend to pursue. We also reported $500,000 of inventory impairment charges. We will continue to evaluate our inventories for potential impairment, which may result in future charges, but the timing and magnitude of these charges will fluctuate, as they have in the past.

Our inactive land held for development of $185 million at the end of the quarter represents 10,500 lots, down 24% from a year ago. We continue to work through each of our remaining inactive land parcels to improve cash flows and returns, and we expect that our land held for development will continue to decline.

Bill?

Bill Wheat (CFO):

At December 31, our homebuilding liquidity included $1.2 billion of unrestricted homebuilding cash, and $871 million available capacity on our revolving credit facility. We had no cash borrowings, and $104 million of letters of credit outstanding on the revolver. Our gross homebuilding leverage ratio was 35.5%, and our homebuilding leverage ratio net of cash was 25.7%.

The balance of our public notes outstanding at December 31 was $3.3 billion. On January 15, we repaid $170 million of senior notes at their maturity, and now we have $373 million of maturities remaining in FY16. At December 31, our shareholders' equity was $6.1 billion, and book value per share was $16.39, up

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14% from a year ago.

Jessica?

Jessica Hansen (Investor Relations):

Our expectations for FY16 remain unchanged from what we shared on our November call, and are based on current housing market conditions. We continue to expect to generate a consolidated pre-tax operating margin of 10.5% to 11% for FY16. We also still expect to generate consolidated revenues of between $12 billion and $12.5 billion, and to close between 39,500 and 41,500 homes. We anticipate our home sales gross margin for the full year of 2016 will be in the high 19%s to 20%, with potential quarterly fluctuations that may range from 19% to 21%.

We estimate that our annual homebuilding SG&A expense will be in the range of 9.2% to 9.4% of homebuilding revenues, with the second quarter of the year higher than this range, and the third and fourth quarters below the range. We expect our annual financial services operating margin to range from 30% to 33%.

We are forecasting our FY16 income tax rate to be between 35% and 36%, and our diluted share count to be approximately 375 million shares. We also continue to expect to generate $300 million to $500 million of positive cash flow from operations. Our FY16 results will be significantly impacted by the spring selling season, and we will update our expectations each quarter as visibility to the spring and full year becomes clearer.

For the second quarter of FY16, we expect our number of homes closed will approximate a beginning backlog conversion rate in a range of 82% to 85%. We anticipate our second-quarter home sales gross margin will be in the high 19%s to 20%, consistent with the first quarter, and we expect our homebuilding SG&A in the second quarter to be in the range of 10.3% to 10.6% of homebuilding revenues.

David?

David Auld (President & CEO):

In closing, our first-quarter growth in sales and profits, and the improvement in our pre-tax margin, are the result of the strength of our people and operating platform. We are excited and prepared for the spring selling season and opportunities ahead.

We remain focused on growing both our revenue and pre-tax profit at a double-digit annual pace, while continuing to generate positive cash flows and improved returns. We are well positioned to do so, with our solid balance sheet, industry-leading market share, broad geographic footprint, diversified product offerings across our D.R. Horton , Emerald and Express brands, attractive finished lot and land positions, and most importantly, our tremendous teams across the country.

We would like to thank all of our employees for their continued hard work, and we look forward to working together to continue growing and improving our operations during 2016. Let's keep the momentum from January going, week by week, into the spring.

This concludes our prepared remarks. We will now host questions.

QUESTIONS & ANSWERS

Operator:

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Nishu Sood from Deutsche Bank.

Nishu Sood (Analyst - Deutsche Bank):

Thank you. Thank you for all of the details as well.

First question I wanted to ask, the tone that you're describing to begin the year is pretty positive. You mentioned the January orders being positive. That's a -- it could imply a pretty broad range.

So, I was wondering if you would be more specific?

And more broadly, the tone that you're describing, it sounds like it is sufficient to -- the absorption momentum is sufficient to meet your revenue and closing expectations for the year.

So I was wondering if you could just comment on that as well, please?

David Auld (President & CEO):

Well, we have a positive tone, because we're seeing positive things happen out in the market. And the absorptions improvement on the relatively flat community count, less pressure on margins, it was a good first quarter. And what we're seeing going into January gives us a lot of confidence.

Bill Wheat (CFO):

And Nishu, just to share a little bit more about January. We're seeing week by week, accelerating sales pace as we would expect to see in January, and it's certainly consistent with typical seasonality, and certainly in line with our expectations and our budget. So we're feeling good about what we're seeing so far, what we produced in the first quarter. Sales we're seeing so far in January are right in line with our plans, and certainly is sufficient to generate the volume that we're guiding to for the year.

Nishu Sood (Analyst - Deutsche Bank):

Great, thanks. And the second question, you folks have had a strategy of being more capital efficient, focusing on return of inventory on the call it, the past 12 or 18 months or so. You've clearly been successful with that, judging from the amount of cash and liquidity that you have at the moment. So normally, a build up of cash like this is the way that you would behave, if you were expecting a downturn in the market, or if you were trying to batten down the hatches.

So without an increase in the dividend or a share buyback, what are your thoughts here? And is that characterization correct? I mean, how can you be drawing back inventory, when we still have 50% or 60% upside potential in single family volumes going forward?

David Auld (President & CEO):

Well, I don't think we're drawing back inventory. As matter of fact, we're guiding I think this year to be up 15%, 20%, and what we're pushing out. Spending, yes. So the focus on efficiency gains and returns, I think are -- have little to do with what we're thinking about whether the market is going to be good or bad. It has a lot to do with, I think, driving and become the best Company in the industry. And the liquidity and strong balance sheet gives us a lot of flexibility. And we'll see what we do with the cash. I mean, it's --

Bill Wheat (CFO):

Nishu, we still see opportunities to invest in the business. We still do expect our land spend to be up -- land development spend to be up 20% this year. We're continuing to add lots under option contracts and

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control, for future growth that direction. But as David said, continuing to drive a more efficient business model for ourselves helps us improve our operational disciplines across the board. And that's been a consistent focus we've had this Company for a long time, and we're seeing a lot of those results bearing fruit right now. And we will be looking to pay off debt with the existing cash. We just paid off I think $170 million in January, and we have another maturity in April of $370 million so (multiple speakers)

Nishu Sood (Analyst - Deutsche Bank):

Okay.

Bill Wheat (CFO):

We feel real good about it.

Operator:

Stephen East from Evercore ISI.

Stephen East (Analyst - Evercore ISI):

Thank you. Good morning.

avid, could you just talk a little bit -- obviously, we're getting a lot of questions about Texas and what's happening with oil. Could you talk a little bit -- rank order your cities as far as the percentage of your business? And maybe talk a little bit about the demand trends that you're seeing, and where you all are investing within the state either -- well I'm looking at, not only investing in communities, but also are you targeting either Express or Emerald? Or is it pretty much across-the-board?

David Auld (President & CEO):

Stephen, pretty much across the board on what we're targeting, pushing out. The Express has been the driver I think, of market share gains. But Texas is in good shape. I've spent the last two weeks driving the Dallas/Fort Worth areas. And I can tell you, if you can put a house in Texas in pretty much any market, and sell it and make a margin at $250,000, you're going to sell houses. So we're focused on improving the value to the customer. We're focused on driving absorption levels up on a community by community basis, and that has been a successful strategy for us in Texas.

As far as revenues, and by cities --

Bill Wheat (CFO):

Dallas/Fort Worth --

David Auld (President & CEO):

Yes, number one, Dallas/Fort Worth, I think we're 15% of the market share today. And to be honest with you, we believe we can expand that, so we love Texas.

Stephen East (Analyst - Evercore ISI):

Thanks.

David Auld (President & CEO):

And we really love our operators in Texas.

Stephen East (Analyst - Evercore ISI):

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Okay. And if I can just follow on the capital allocation that you talked about, your land and development be up about 20%? Did I understand you right, Mike, that your $370 million this spring, you'll actually pay that off? And then as you look at M&A, one, what are you seeing out there, and what's your appetite for it?

Bill Wheat (CFO):

So we will, with the $370 million maturing, we have adequate cash to pay that off today, and to be opportunistic if we look at any portion -- some or all of that within refinancing, depending upon where -- what the markets look like and timing to hit that. With M&A, we continued to be very inquisitive if you will, and look at a lot of opportunities.

The bar is pretty high for us, in looking at acquisitions that make sense. We have a great footprint today. We have good operations. And adding on to that is a high bar, so we will be very disciplined with -- on the M&A front.

Stephen East (Analyst - Evercore ISI):

Okay. Is the activity picked up?

Bill Wheat (CFO):

It's been running at a very high pace in terms of lots of activity for awhile. I wouldn't say its picked up in the past quarter. It's been running at a good clip.

Stephen East (Analyst - Evercore ISI):

Okay. Thank you.

Operator:

Stephen Kim from Barclays.

Stephen Kim (Analyst - Barclays Capital):

Hello. Good quarter. Lots of interesting things going on.

I guess, the first question that I had relates to what you're seeing, with respect to the first-time buyer activity? And I know that, at least on the entry level side as long as you -- to the degree those things go hand in hand, you all have been leading the market with your Express . But the data we look at, shows that beginning in April of last year, the first-time buyer activity has markedly improved, is now up nearly 20% year on year.

And yet, we are still not seeing your competitors indicating that they're seeing in sufficient activity out there, to warrant them going out there. So it's quite an unusual situation, where you really seem to have that end of the market to yourselves. And I would just say, can you shed a little light on, a, are you in fact feeling a pick up in the market at the first-time buyer area, or second in the market since the summer of last year -- did you -- have you seen that? And, b, do you have any more current thinking as to how the competitive dynamics addressing that market may change or not in 2016?

David Auld (President & CEO):

Well, as far as the market picking up, as we continue to push out the Express brand, we are continuing to see consistent absorption and demand. So we are in the process of pushing that brand out across the

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country. And everywhere we've gone, we've seen good absorption and margins at or above what we underwrote them at.

Mike Murray (COO):

To the competitive landscape, certainly, the entry level, the lower end of the market is certainly the strongest right now. And any time we see that in the market, we expect further competition. You're right. We haven't seen a whole lot in a lot of our markets. We probably haven't seen as much as we expected, but we do expect more as time goes on.

Stephen Kim (Analyst - Barclays Capital):

Great. And then, touching back on this interesting juxtaposition of strong -- of cash flow generation next year, which is an unusual thing, and usually doesn't happen early in a cycle, with your fairly optimistic commentary about the market and your position within it, I would just point out that your comment about a 20% increase in land spend next year would still imply a very low ratio relative to revenues, which is just essentially, you're basically barely replenishing what you're burning off, in terms of dollars invested in land -- which isn't a bad thing. It's just that I would point out that that does still -- it sounds to me even though you're couching that in terms, and make it sound like you're sort of leaning forward on land investment, it actually isn't.

It sounds to me like on balance, you're being relatively judicious, very judicious actually historically in your land spend next year. I'm curious as to touching on what you've said in the past what you intend to do with the cash that you are going to be building over the course of the next year? Do you, for instance, envision using that more for debt pay down, M&A, over the course of the next two to three years?

Bill Wheat (CFO):

Yes, Steve, first, to your comment about this replenishing our land supply. We feel very good about the level of our land supply, in terms of what we own. And we are -- the 20% or greater spend that we're essentially expecting does replenish our land supply. And we feel like that is a sufficient level to support the growth expectations and guidance that we have provided. But we are definitely taking a balanced approach, and keeping the investment levels within a disciplined range. And with that, that's definitely generating a lot of cash flow.

As far as how we look at our cash position today, we've talked a bit about our debt maturities. To the extent the market is favorable, we would still issue new debt. Refinance rates are still certainly very attractive, and we continue to look for investments in our Business. If we see great investments that would push our land spending up to 25% or 30%, we feel like it generates a great return, we will do that. And as Mike has already talked about M&A, there are a lot of opportunities. And then, hopefully, there will be some that come along and meet our threshold, and this cash position puts us in a great flexible, opportunistic position to be able to take advantage of that.

And so, today, in terms of priorities, we would list investing in our business, which would include potential M&A, taking care of our debt maturities along the way, as our top priorities. And beyond that, we're going to remain in a flexible and opportunistic position for the next year.

Stephen Kim (Analyst - Barclays Capital):

Well, it's a good position to be in. So congratulations for putting yourselves in that position. Thanks.

David Auld (President & CEO):

Thank you.

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Operator:

Alan Ratner from Zelman & Associates.

Alan Ratner (Analyst - Zelman):

Hey, good morning, and thanks for taking the question. Nice quarter.

First question is on the spec front. If I'm -- I think I'm looking at the right number here. It looks like year-over-year, you're down roughly 20% on completed specs, 10% on total. And yes, I think that you're expecting relatively lower growth this year than last year. But is there any conservatism baked in there, just given some of the macro uncertainties we're seeing now, where -- maybe just talk a little bit about the thought process, and where you see your spec count heading into the selling season?

David Auld (President & CEO):

I would -- this is David. I would say, no baked in pessimism. I mean, we are attempting continue to do what we've been doing, which is consolidate market share in a market by market program. We are measuring and trying to control the finished inventory and keep it turning, because that drives SG&A leverage, and it also drives significant efficiencies in the operations.

Bill Wheat (CFO):

And we feel like we're in a good position for the spring. Started a lot of houses in the first quarter, and we're going to start a lot of houses in the second quarter too, to feed the sales that we expect. But with that, just like we are with the land, we are remaining disciplined community by community. And so, I think we have gotten a bit more efficient with turning our specs over the last year.

Alan Ratner (Analyst - Zelman):

Great. Thanks for that, and a second follow-up if I could. It sounds like you are pretty bullish on the January activity. I think the big concern that investors have is that the stock market volatility here is going to -- maybe more at the higher end cause some skittishness among buyers there. So given your diversification on the product side, have you seen any differences in buyer activity between your Emerald division, and maybe down to the Express division? Or are the comments you had company-wide pretty consistent from price point?

David Auld (President & CEO):

I'd say, pretty consistent. There is a slower movement on the Emerald. The higher price points are not seeing same levels of activity that we're seeing in the Horton or the Express brands.

Alan Ratner (Analyst - Zelman):

Is that a rate of change comment, meaning it slowed over the last month or two? Or is that just generally speaking, you get lower absorptions, which I think would be expected?

David Auld (President & CEO):

I would say, rate of change over the last couple of quarters. I can tell you, right now January has started off very good so.

Alan Ratner (Analyst - Zelman):

Great. Well, thanks a lot, and thanks for taking the questions.

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Bill Wheat (CFO):

Thank you.

Operator:

Thank you. Our next question today is coming Eric Bosshard from Cleveland Research.

Eric Bosshard (Analyst - Cleveland Research Company):

Good morning. In terms of Express , just curious what you're seeing in the market, and how you're managing that in terms of price points? And also the mix of that product; it's obviously been successful. But curious, how you're managing that, and how you're seeing behavior of the first-time or that home buyer evolving in this market?

Jessica Hansen (Investor Relations):

Sure, Eric. As David mentioned, we've been very pleased with the roll out of Express . We've talked to you for several quarters that the majority of that business has been in Texas, the Carolinas, and Florida. That's still the case. The majority of our sales and closings are coming out of those markets, but we're starting to see a more meaningful share from some other parts of the country.

The next largest state for us, actually right now is California. The majority of that is in our Southern California markets, and that is bringing our average price point for Express up. This quarter it was $199,000. Though in our next quarter, more than likely we'll be over the $200,000 mark with our Express homes product offering, but really just due to geographic mix. And we've been very pleased with the roll out of Express in those other markets, in addition to Texas, Carolinas, and Florida where the reception still remains very strong.

Eric Bosshard (Analyst - Cleveland Research Company):

In terms of intentionality of how the product is moving in existing markets, and I appreciate the California expansion, but is there anything that is different, either from a price or cost or efficiency standpoint that's materially different than where its been, or in terms of where it's going?

David Auld (President & CEO):

I would say, pretty consistent with where its been, and we're going to drive where it's going so. But the Express program is price point driven. So we set absorption targets and drive to that price point. So the overall Express program has been well-received, and continues to exceed what we thought it would be when it came out.

Eric Bosshard (Analyst - Cleveland Research Company):

And then secondly, in terms of your expectations for price or incentives -- and obviously you're going to wait to see how the spring selling season develops, but can you speak a little bit to what plan A look like in regards to that relative to a year ago?

Bill Wheat (CFO):

I think what we're seeing with good absorption in the communities, is taking pressure off margins and it's giving us, in certain communities a little bit of pricing power to reduce incentives. And that's been showing up positively in margins. We plan to continue that. The Plan A is to maintain the absorption pace that we've budgeted for the year, and we're seeing the market being very cooperative to that.

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Eric Bosshard (Analyst - Cleveland Research Company):

Great. Thank you.

Operator:

Mike Rehaut from JPMorgan .

Mike Rehaut (Analyst - JP Morgan):

Thanks. Good morning, everyone, and congrats on a solid quarter.

David Auld (President & CEO):

Thank you, Michael.

Mike Rehaut (Analyst - JP Morgan):

First question I had was just trying to drill down a little bit across the regions, from the order growth perspective during the quarter. You had, for example, some deceleration in year-over-year order growth across the board, but more notably in the Southeast, still very strong at 22% growth versus -- but that was versus a stronger rate in 2015. A couple of smaller regions fell off, as well. So I was hoping to get any kind of color across the regions, in terms of perhaps highlighting which markets right now that you might see as being stronger than others? And if there was any particular changes in community count growth that might have driven some of those regional changes quarter to quarter in terms of the year-over-year trend?

Jessica Hansen (Investor Relations):

Yes, we saw an increase in our absorptions in every region, Mike, outside of the Midwest. The Midwest is a very small region for us, and it does include Chicago, which we've pointed to for awhile now as being a weaker market of ours. But otherwise, every region in terms of sales on a year-over-year basis was up, as we did see a decline in our community count in half of our regions. And as we noted already, our count -- community count was relatively flat. It was up just almost slightly at about 1% on a year-over-year basis. So we're seeing a good pick up in absorptions in a majority of our markets today, I would say.

Mike Rehaut (Analyst - JP Morgan):

Okay. No, that's helpful. Secondly, just from the growth side, I think there's been a couple of questions previously around growth expectations. And your land spend up, but kind of keeping your lot cap -- count flat, and basically replacing what you're working through.

Just thinking, at the same time, you're expecting, I believe you said double-digit growth. Correct me, if I'm wrong, that's your goal over the next two or three years. So how are you, at least from a revenue or order growth standpoint, now with community count flattish for three quarters, maybe for another couple quarters here, is growth something that would be reinfused into the strategy, as we think about FY17 and FY18?

Obviously, you're also creating a lot of dry powder here, building up the cash, or paying down some debt incrementally? And it seems like there's a little bit of a -- one foot on the pedal, or halfway on the gas pedal, whereas again you're still well below mid cycle levels as an industry? So any thoughts around, perhaps a reacceleration of that community count growth as we look into 2017 or 2018?

David Auld (President & CEO):

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I think we're looking for -- to continue to aggregate market share market by market. I think we're looking at double-digit growth year-over-year, and profit sales and closings. So it's -- we get what we believe is a sustainable program. And the fact that we're generating cash, and improving our balance sheet while gaining efficiency, it's just going to open a lot of opportunities for us down the road.

Bill Wheat (CFO):

And growth is a core part of that strategy. Growth at a double-digit pace is a core part of that strategy, but it is a balanced strategy. Our guidance for this year, in terms of top line revenue equates to an 11% to 15% annual increase.

Our closings guidance for the year equates to an 8% to 13% increase. And so, our expectations this year are to be in the low double-digit range, which from our perspective is solid growth and in line with our expectations. In this quarter, with our sales pace, it's in the range of our expectations for the year, and certainly puts us in position to continue in consistent growth.

Our investment levels, we've gotten a lot of our growth the last couple years from absorption improvements with the Express roll out, while our average community count has moderated. Our expectations this year is, while we'll still see absorption improvements, it won't be quite at the pace it was in prior years, but we still expect solid absorption improvements. And then, certainly, going forward when we achieve a much better level of efficiency, than perhaps in future growth at a double-digit pace may come from some further community count growth. But today, and for this year, we expect low -- flat to low single-digit community count growth, with improved absorptions to drive a double-digit revenue growth.

Mike Rehaut (Analyst - JP Morgan):

No, that's helpful, Bill. And I think just maybe to press that further, that concept in terms of the shift between community count and absorption that's occurred in the last six or eight quarters, this year again, it looks like perhaps a high single-digit or so, perhaps low double-digit absorption growth, with more flattish community count. To the extent that you're coming -- that that growth would continue to moderate, perhaps due to the mix shift more fully playing out from the Express standpoint, to the extent, that you're expecting double-digit growth in 2017, it would imply, to the extent that the absorption continues to moderate, some reacceleration in community count. Is that fair?

Bill Wheat (CFO):

I believe that's fair, yes.

Mike Rehaut (Analyst - JP Morgan):

Great. Thanks a lot.

Operator:

Thank you.

(Operator Instructions)

Our next question today is coming from Ken Zener from KeyBanc.

Ken Zener (Analyst - KeyBanc):

Good morning, all.

David Auld (President & CEO):

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Good morning, Ken.

Ken Zener (Analyst - KeyBanc):

So I wonder if you could talk about this 50% of your buyers that are not first-time. Obviously, it appears that there's volatility on the existing home sales number in December, some of that --mortgage related. But it does seem that things are decelerating a little bit on the existing side. Is there anything that would cause you concern, or David, Bill, could you talk about what a gumming up of that existing side might look like, and how that might concern you?

I know obviously, Houston is starting to see rising inventory of existing, and slowing the existing sales. Have you started seeing, in any of the markets issues with people not being able to sell their houses or anything? So that was a big part of the market last time, when it started to slow down.

David Auld (President & CEO):

I'll tell you, Ken, we are not seeing that. In the markets we are operating at. The resale market is still relatively strong, with continuing positive signs. So I mean, our inventory turns are improving. Our absorptions [supplies] are improving, with stable and in some cases improving margins. So we feel very good about the market right now. And are not seeing -- other than obviously, Houston is slow, but the balance of our markets are doing very, very well.

Ken Zener (Analyst - KeyBanc):

And then, if I could ask about California where you did highlight your -- some Express product. Jessica, you talked about it lifting your ASP. And then, also as it relates to any of your other product, what percent of those homes do you believe are going to or towards investors, be it -- if you can split it out, domestic and/or international? Thank you.

Bill Wheat (CFO):

We don't have an exact break down of the investors. Anecdotally, I'd tell you it's very low, what we're hearing about any investor sales. A lot of it is, just people that are moving out of a rental situation into a home that they can afford.

Ken Zener (Analyst - KeyBanc):

Thank you.

Operator:

Bob Wetenhall from RBC.

Bob Wetenhall (Analyst - RBC):

Hi, good morning. Did you get any help with the December weather? Did that extend the construction season, and assist with deliveries in Q4?

David Auld (President & CEO):

We had real weather, in the fourth quarter, in a couple of our bigger markets, across the Carolinas, and really Dallas/Fort Worth. But as Mike points out, we have weather every quarter. So would our numbers have been better with typical weather? Yes, they would have been. But we're very happy with the numbers we posted, and think we're going to have a great year.

Bob Wetenhall (Analyst - RBC):

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It sounds like, and especially with the start, ASP was up 3.3%, and average price growth of 2.7% on the new order side. And you're talking about maintaining a 19.5% to 20% gross margin. I'm just trying to get a better picture of how to think about prices being low single-digit, what you're seeing on the labor cost side, and if you're experiencing any delays due to labor bottlenecks, and if that's been resolved? How -- what's really giving you the confidence to reiterate your guidance for a very solid margin performance this year? Thanks very much.

David Auld (President & CEO):

I think that the confidence is coming from being in touch with the operators out in the divisions, and what they sense, and what they feel is taking place in their markets. And across the board, our people feel very good about what's happening out there. The labor side, I would say, it's still stressed, but seems to be improving, and the trade bases are starting to add people.

I think a big part of the improvement we're seeing is the consistency of production in the community by community is allowing these trades to staff and maintain a workforce to hit those numbers. And it's taken awhile to get there, but they are adding people. I think our trade base is seeing -- is becoming more and more confident, as well.

Jessica Hansen (Investor Relations):

And Bob, in terms of what we saw in price changes, our revenues per square foot outpaced our stick-and-brick per square foot on a year-over-year basis for the second time. So we've gotten to where that's in check. Sequentially, that was essentially net neutral. So you saw our margin tick up by 10 basis points year-over-year, and stayed flat from Q4 to Q1. We are continuing to experience higher land costs, but in about the same range year-over-year as we were last quarter, so flat gross margins.

Bob Wetenhall (Analyst - RBC):

And let me ask you, Jessica, just on that point. Are you really getting price, or is the driver really a reflection of a stronger mix, with the bias towards the West Coast?

Jessica Hansen (Investor Relations):

We're actually getting price. If we look at our price per square foot, which is the best way we can try to look at our business apples-to-apples, we did see a low single-digit increase.

Bob Wetenhall (Analyst - RBC):

Got it. And if I can sneak one final in. Can you just give us like a way to think about Houston versus Dallas, in the sense that it sounds like Dallas is very strong. You said Houston is soft. How do we think about that? Is there anymore of a bookend you can give us? Thanks a lot.

David Auld (President & CEO):

I will tell you, Bob, I spent a week driving Dallas, and a week driving Fort Worth in January. And when I got back, I told Horton I had to get out of the field because if I stayed in Dallas and Fort Worth, I would become way too aggressive buying land. It is as good of market as I've seen.

And as to Houston, I think that there's a lot of conversation, a lot of uncertainty, a lot of volatility within the oil and gas business, which I think is making people more conservative about buying homes. And I think there's still pent-up demand in Houston. I think the pent-up demand is growing. But it is just not the frenzy that we've seen in the past, or is really taking place in some of the other Texas markets.

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Bob Wetenhall (Analyst - RBC):

Super. Good. Good luck, and thanks very much.

David Auld (President & CEO):

Thank you, Bob.

Operator:

the line of Jay McCanless from Stern Agee.

Jay McCanless (Analyst - Sterne Agee CRT):

Thank you. If I could, maybe I can touch on the labor issue? I think some people are concerned about, would there be enough labor to make the number of closings in the back half of the year that your guidance suggests. Could you talk -- I mean, when you talk about labor getting better, and the subs adding more people, is it across-the-board, or is it just in specific market, or specific areas like framing, et cetera?

David Auld (President & CEO):

It's pretty much across the board. I mean, we're seeing construction labor force increase. And I think, and our strive to create more efficiency in the process of building and selling homes, and trying to actually take some labor out of a per square foot cost for the home has paid off. And our trades are making money, and we're seeing less pressure on the cost side, and I think providing more value for the customer. So we feel like we are positioned to deliver our year.

Jay McCanless (Analyst - Sterne Agee CRT):

Okay, great. And then, the second question I had, on Express , could you just update us on how many markets you ultimately want to go to with that product, and how far along you think you are in that process?

David Auld (President & CEO):

Oh, I think there are -- probably, we're in 78 markets. We probably will end up mid 60s, primarily because some markets just don't -- we've -- don't allow you market your product, and we aren't going to give up the Horton brand to sell Express . We have a lot of opportunity still to increase our position within most of the markets, and are actively out there looking every day to do that.

Jay McCanless (Analyst - Sterne Agee CRT):

Okay. And how far along do you think you are in that process?

David Auld (President & CEO):

Maybe half way.

Jessica Hansen (Investor Relations):

We're in 48 markets in 15 states today. But to echo David's comments, we haven't fully saturated the markets that we're currently in with Express . So there's more runway within those 48, plus expanding into the mid 60s.

Jay McCanless (Analyst - Sterne Agee CRT):

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Got it. Thanks.

David Auld (President & CEO):

I mean, we are allocating capital to the programs that are driving the best returns, and right now Express is driving the great returns.

Jay McCanless (Analyst - Sterne Agee CRT):

Okay. Thanks for taking my questions.

Operator:

Mike Dahl from Credit Suisse.

Mike Dahl (Analyst - Credit Suisse):

Hi, thanks for taking my questions.

David Auld (President & CEO):

You bet.

Mike Dahl (Analyst - Credit Suisse):

David, if we could go back and put a finer point on the Texas discussion, it sounds like Dallas is clearly very strong. And if I look at your South Central trends overall, up 7% in orders, Dallas presumably outpacing that by a decent degree. So Houston: can you give us a ballpark around year-over-year, what Houston is doing? And we've heard some other builders talk about the weakness extending down to the $250,000 price point. I know you said earlier, you put up -- if you can put up a home at $250,000, you can sell it. But is there just any additional color on trends that -- across the price segmentation within your Houston business that you can provide?

Jessica Hansen (Investor Relations):

Houston has been relatively stable for us on a year-over-year basis. And so, we didn't see a further slowdown in Houston, but we're also not seeing any meaningful pick up. We continue to see our lower-priced Express homes, very steady demand, steady sales pace. But as had been mentioned a couple times on the call, definitely softer at the higher end. But we continue to see good steady demand for the entry level, and people moving out of apartments, where we're providing an attractive rent versus buy equation, and driving people into those sales offices each week.

So we continue to have a close eye on Houston. We are not heavily reinvesting in Houston right now. We are replenishing where it makes sense, and where we can continue to add those entry level product offerings.

David Auld (President & CEO):

Mike, just to add a little more color. We have some, what I would call, A-plus project location positions in Houston, that are maybe at the price point that we're seeing less demand for. And we are not going to accelerate or liquidate those positions. So we will see lower absorptions in those communities. And these are -- they're communities we can't go replace, and don't want to. So it's -- we're going to protect the value in our core projects, take absorption at the $250,000 to $300,000 range.

And if you're looking at what I look at, almost zero margin deterioration on the projects that are at the price point that are turning right now. And we don't need, nor do we want to force sales in the core

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project where we have been selling $350,000 to $450,000, and are just seeing where absorption's reduced. So that's my color on Houston. It's going to be a tremendous market for us for a long time.

Mike Dahl (Analyst - Credit Suisse):

Just a follow-up on that last point. As you take a step back and say, look, there's too much value in some of these A-plus locations to give them away, we have heard increased chatter, in terms of that competitors are starting to cut prices, or kick up incentives. So how much of it is related to the market is trading away from you, and you're not chasing it, but the market has moved on price?

David Auld (President & CEO):

We are very strong in the -- I mean, we dominate the $250,000 to $300,000 -- $200,000 to $300,000 price point in Houston. And we're going to continue to dominate that. And if you look at our -- the benefit -- one of the many benefits of being D.R. Horton is the broad geographic footprint.

When the upper end in Houston slows down, the entry level in Denver accelerates. So I mean, it's -- we have a lot of levers to pull. My consistent comment to the people inside the Company is, it's good to be us, because we can hit our plan, and without being forced to sell a project we don't want to sell at the pace that its been running at.

Mike Dahl (Analyst - Credit Suisse):

Got it. That is helpful. And yes, a good position to be in. If I could shift gears to another order of discussion around community count and absorptions. And just as it relates to the guide, I think you had mentioned unit deliveries up 8% to13%. If we look at the orders, it seems like absorption is up about 8%. How much of the delta between hitting the low end versus the high end of the units will come from increasing your absorption beyond that 8% on a year-over-year basis, versus getting more communities open, and getting that community count up into a low to mid single-digit range by the end of the year?

David Auld (President & CEO):

Well, we're pretty much running on our absorption targets. So, I think we will as we continue to push out the Express brand, and follow up replacing the Horton positions, I think we will see some community count growth. We don't have visibility into that today. We do have visibility into what we know we can deliver so.

Bill Wheat (CFO):

It's hard to know exactly where the contributions are, sitting here in January, not knowing what the spring is going to hold. We're certainly seeing good early signs. But clearly, the strength of the spring selling season will help determine our year. It will determine where we land in our range, or whether we could perhaps exceed our range. And so, it's -- sitting here in January feeling good, feel good about our position, our preparations for the spring. And then, we'll go try to execute as best we can over the next few months. And we'll know a whole lot more when we talk to you next quarter.

Mike Dahl (Analyst - Credit Suisse):

Okay, great. Thank you.

Operator:

Will Randow from Citigroup .

Will Randow (Analyst - Citigroup):

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Hey, good morning, and thanks for taking my questions.

David Auld (President & CEO):

Hi, Will.

Will Randow (Analyst - Citigroup):

Hello. I was curious on the implementation of the know before you owe, or [TRID] if you will, for you, how that looked like? How do you feel about, for lack of a better term, the complexity as well, as days it has added to closings? And if you'd share some color there?

Mike Murray (COO):

We really haven't seen an appreciable impact, and a delay in closings. Our teams have worked very hard to prepare for the changing rules, and worked with our captive mortgage company. DHM Mortgage and Associates have done a yeoman's job preparing for this change, as well as working with our preferred lenders. So we really didn't see a material impact on our closings for the quarter. We'll continue to improve our processes, and try to become more efficient, and make it a good experience for the buyers.

Will Randow (Analyst - Citigroup):

Thanks for that. And then, just as a follow-up, as talked about a few times during Q&A. But on labor inflation, I think you are running at 2% or 3%. In the prior reported quarter, well, some of your competitors out there are running closer to 10%, have you seen more inflation? And has that been different for specs versus the total Company?

David Auld (President & CEO):

I think the labor side has been minimized for us, because we set absorption targets per community and drive to that, so we have consistency within the communities. And our trades are not out there looking for work one week, and then have twice what they can do the next.

Jessica Hansen (Investor Relations):

We are still just running a low single-digit percentage increase on cost per square foot, stick-and-brick.

Will Randow (Analyst - Citigroup):

All right. Thanks for that, and congratulations on the progress.

Operator:

John Lovallo from Merrill Lynch.

John Lovallo (Analyst - BofA Merrill Lynch):

Hello. Thanks for taking the call. First question is on the financial services margin. We have it at about 16% I think in the quarter, versus a guide of 30% to 33%. Now was there any TRID-related expenses lumped in there in the quarter?

Bill Wheat (CFO):

Yes, no doubt. The -- to be prepared for the new regulations our mortgage company financial services operation had to make significant investments, primarily in personnel. The effort to comply is a big one. And in order to meet those regulations and provide that experience to the home buyers, they've had to

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increase costs there. Typically though, season -- on a -- from a seasonal basis, we see our lower operating margins in our first and second quarters, in our lower volume quarters. And then, we typically see higher than average operating margins in financial services in Q3 and Q4. And so, the margin here this quarter, in the low 20%s certainly does not preclude achieving the 30% to 33% guidance for the year.

John Lovallo (Analyst - BofA Merrill Lynch):

Okay. That's helpful. And then, if -- the one follow-up would be, realizing that weather is an issue every quarter somewhere, the recent weather we've had on the East Coast has been pretty serious, particularly in areas like Carolina that aren't used to having that kind of impact. So I mean, are you anticipating any trouble in the coming quarter due to this storm?

Bill Wheat (CFO):

Certainly do appreciate it has been a serious storm. It's impacted a lot of people. But we feel -- it's fortunate, it's early in our quarter, and our operating teams will be able to take care of our existing homeowners in the communities, and deal with the homes that are in backlog, and the specs that out there today, and be ready for sales next weekend.

David Auld (President & CEO):

I'd also like to add, it's a beautiful day in Texas today, as they say. The sun is shining on somebody somewhere every day.

Bill Wheat (CFO):

My house in Texas.

John Lovallo (Analyst - BofA Merrill Lynch):

All right. Thanks.

Operator:

Thank you. Our final question today is coming from the line of Susan Maklari from UBS.

Susan Maklari (Analyst - UBS):

Thank you, good morning.

David Auld (President & CEO):

Good morning.

Susan Maklari (Analyst - UBS):

You have talked frequently about how you've just not seen a lot of competition coming into the first-time Express price points. What do you think is the biggest factor that would have to change, either from an operating industry perspective, or from a macro perspective that would finally push some of those peers, maybe perhaps come in, and create a bit more of competition for you there?

David Auld (President & CEO):

Well, I -- we have a hard enough time managing our people. I don't want to get into trying to help them help themselves. So I don't know. All we do, is get up every day and operate, and pursue to be the best we can be. And we're tough competition. Maybe they just -- I don't know.

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Bill Wheat (CFO):

But entry level housing is something we've done for a very long time. It's a core competency of our Business. It -- and with our footprint, and with that competency among our operating teams across the country, it's something that we've got a lot of practice at. So it's something we're focused on. And like we said earlier, it's a good market, and there's a lot of demand there. We do expect some more competition down the line, and I think that would be a natural next step in the cycle.

David Auld (President & CEO):

I will say, we were first movers, and we were aggressive first movers. And I would believe that the other companies that are also good at driving value will be following us in it. But we bought the lion's share of the finished lots. And when we saw the success, we started investment, investing in development, developing lots. So we just have a head start. I'm sure they're coming.

Susan Maklari (Analyst - UBS):

Okay. And then, just following up on TRID. Obviously, (inaudible) has done a great job in rolling that out. But as we do get into the spring, and start to just see overall activity level increase, do you see anything out there that starts to trip things up at all?

Bill Wheat (CFO):

Well, the area that we've watched the most closely, that we have less visibility too, are the closings with outside lenders. Obviously, our internal mortgage company are captive closings, so we have more visibility to that process, and feel confident about that. But with outside lenders, it's something we watch closely division by division, or they have relationships with outside lenders. They are working with them to make sure that we have the visibility to hit things on time. But I think that's where the greater risk is. But I honestly think, month by month, as everyone in the process gets more used to it, I think it will get smoother. And any disruptions that may have occurred thus far, I think will be alleviated over the coming months.

Susan Maklari (Analyst - UBS):

Okay. Thank you.

Operator:

Thank you. We've reached the end of our question and answer session. I'd like to turn the floor back over to management for any further or closing comments.

David Auld (President & CEO):

Thank you, Kevin. We appreciate everyone's time today, and look forward to speaking with you again in April. Again, special thanks to the D.R. Horton team. You've -- outstanding first quarter, outstanding start to the year.

Operator:

Thank you. That does conclude today's teleconference.

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