

## **Company Participants**

Ashley Dagley - Corporate Securities Council & IR

Daniel Bartok - CEO

James Allen - CFO

Mark Walker - COO

## **Conference Call Participants**

Carl Reichardt - BTIG

Truman Patterson - Wolfe Research

Douglas Wardlaw - JPMorgan

Anthony Pettinari - Citigroup

## **Operator**

Good afternoon, and welcome to Forestar's Fourth Quarter and Fiscal 2023 Earnings Conference Call. [Operator Instructions] Please note, this conference is being recorded.

I will now turn the call over to Ashley Dagley, Corporate Securities Council for Forestar.

## **Ashley Dagley**

Thank you, John. Good afternoon, and welcome to the call to discuss Forestar's fourth quarter and fiscal 2023 results. Thank you for joining us.

Before we get started, today's call includes forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Although Forestar believes any such statements are based on reasonable assumptions, there is no assurance that actual outcomes will not be materially different. All forward-looking statements are based upon information available to Forestar on the date of this conference call and we do not undertake any obligation to update or revise any forward-looking statements publicly.

Additional information about factors that could lead to material changes in performance is contained in Forestar's annual report on Form 10-K and its most recent quarterly report on Form 10-Q, both of which are filed with the Securities and Exchange Commission. Our earnings release is on our website at [investor.forestar.com](http://investor.forestar.com), and we plan to file our 10-K late next week. After this call, we will post an updated investor presentation to our Investor Relations site under Events and Presentations for your reference.

Now I will turn the call over to Dan Bartok, our CEO.

## **Daniel Bartok**

Thanks, Ashley. We appreciate you filling in for Katie this quarter. Good afternoon, everyone. As always, we appreciate your interest in Forestar and taking the time to discuss our fourth quarter and fiscal year results. I'm pleased to also be joined on the call today by Jim Allen, our Chief Financial Officer; and Mark Walker, our Chief Operating Officer.

The Forestar team finished the year strong, highlighted by net income increasing 43% from the prior year quarter to \$72.4 million or \$1.44 per diluted share. Pre-tax income in the fourth quarter increased 44% to \$95.4 million, and our pre-tax profit margin was 17.4%. Revenues for the quarter increased 44% to \$549.7 million, while lots sold increased 27% to 4,986. While our fourth quarter performance was substantially stronger than a year ago, the first half of fiscal 2023 was challenging.

Despite the challenges and volatility that occurred this year, we maintained double-digit returns and a strong pre-tax profit margin of 15.4%, while generating \$364 million of operating cash flow and increasing our liquidity to \$1 billion. Our book value per share increased 14% from a year ago, and our return on equity was 13.2%.

As we begin fiscal 2024, Forestar is well positioned, both financially and operationally to capitalize on builder demand for finished lots. We will continue to focus on investing for our future growth, turning our inventory, maximizing returns and consolidating market share in the highly fragmented lot development industry.

Jim will now discuss our fourth quarter and fiscal 2023 financial results in more detail.

### **James Allen**

Thank you, Dan. In the fourth quarter, net income increased 43% to \$72.4 million or \$1.44 per diluted share compared to \$50.8 million or \$1.02 per diluted share in the prior year quarter. Revenues for the fourth quarter increased 44% to \$549.7 million compared to \$381.4 million in the prior year quarter. The current quarter includes \$64.1 million in tract sales and other revenue and \$4.3 million in revenue from deferred development projects. Lots sold during the quarter increased 27% to 4,986 lots with an average sales price of \$97,400.

We expect continued quarterly fluctuations in our average sales price based on the geographic location and lot size mix of our deliveries. For the fiscal year, net income decreased 7% to \$166.9 million or \$3.33 per diluted share compared to \$178.8 million or \$3.59 per diluted share in the prior year. Revenue for fiscal 2023 totalled \$1.4 billion, which includes \$132.2 million of tract sales and other revenue and \$29 million in revenue from deferred development projects. During fiscal 2023, lots sold decreased 21% to 14,040 lots with an average sales price of \$91,000.

Mark?

### **Mark Walker**

Our fourth quarter pretax income increased 44% to \$95.4 million compared to \$66.4 million in the prior year quarter and our pretax profit margin was 17.4%, consistent with the prior year quarter. Our gross profit margin this quarter was 21%, down 200 basis points sequentially and 240 basis points from a year ago. Pretax income for fiscal 2023 totaled \$221.6 million compared to \$235.8 million in fiscal 2022, and our pretax profit margin for the year was 15.4%.

Our gross profit margin for the year was 21.2%, down 10 basis points from the prior year. During fiscal 2023, we recorded \$19.4 million of noncash real estate impairment charges to cost of sales, reducing our pretax profit margin by 140 basis points and our gross profit margin by 130 basis points. Excluding real estate impairment charges for fiscal 2023, pretax profit margin and gross profit margin were 16.8% and 22.5%, respectively.

Jim?

### **James Allen**

In the fourth quarter, SG&A expense was \$26.4 million or 4.8% as a percentage of revenues compared to \$23.7 million and 6.2% in the prior year quarter. For the year, SG&A expense was \$97.7 million or 6.8% as a percentage of revenues, up 60 basis points from 6.2% in the prior year. We will continue to focus on controlling our SG&A costs while ensuring that our infrastructure supports our business.

Mark?

### **Mark Walker**

As for current market conditions, the supply of new and existing homes at affordable price points remains limited and demographics supporting housing demand remain favorable despite higher mortgage rates and inflationary pressures. Builder incentives have helped bridge the affordability gap for many homebuyers and low resale supply continues to be a driver of buyers choosing new construction. The supply of vacant developed lots, particularly at affordable price points, continues to be constrained across our footprint. And we are

uniquely positioned to take advantage of the shortage of finished lots. We are focused on developing lots for homes at affordable price points demonstrated by our average sales price this year of roughly \$90,000.

Availability of contractors and necessary materials has improved over the past several months, but we have not seen overall reductions in the cost to develop land. We will continue to value-engineer our projects and work with our trade partners to develop in the most efficient way possible. Homebuilders continue to compete to secure land and lot positions. Many are looking to replace current closeout communities to position for future growth. As a result, we are not seeing any softening in land prices. However, in most markets, we have seen an adjustment back to more normal contract terms.

Dan?

### **Daniel Bartok**

D.R. Horton is our largest and most important customer. 15% of the homes D.R. Horton closed this year run a 4-star developed lot. Our mutually stated goal is for one out of every 3 homes that D. R. Horton sells to be on a lot developed by Forestar. We have significant opportunity to grow our market share within D.R. Horton.

We are also working to expand our relationships with other homebuilders and have an intermediate-term goal of selling 30% of our lots to builders other than D.R. Horton. We sold lots to 26 unique customers in fiscal 2023 compared to 22 customers in the prior year and 14% of our fourth quarter deliveries or 684 lots were sold to other homebuilders.

Jim?

### **James Allen**

Forestar's underwriting criteria for new development projects remains unchanged at a minimum 15% pretax return on average inventory and a return of our initial cash investment within 36 months. During the fourth quarter, we invested approximately \$340 million in land and land development, of which \$210 million was for land development and \$130 million was for land. For the full year, we invested approximately \$980 million, of which \$780 million was for land development and \$200 million was for land. In fiscal 2024, we currently expect our investments in land acquisition and development to total \$1.5 billion to \$1.6 billion. Mark?

### **Mark Walker**

Our lot position at September 30 was 79,200 lots, of which 52,400 lots are owned and 26,800 lots are controlled through purchase contracts. 6,400 of our own lots are finished. We continue to target a 3- to 4-year owned inventory of land and lots, and remain focused on managing our development phases to deliver finished lots at a pace that matches market demand, consistent with our emphasis on capital efficiency. 29% of our owned lots are under contract to sell representing approximately \$1.3 billion of future revenue. These contracts have \$121.4 million of hard earnest money deposits associated with them. Another 32% of our owned lots are subject to a right of first offer to D.R. Horton based on executed purchase and sale agreements.

Jim?

### **James Allen**

We have significant liquidity and are using modest leverage to keep our balance sheet strong. We ended the quarter with approximately \$1 billion of liquidity, including an unrestricted cash balance of \$620 million and \$380 million of available capacity on our undrawn revolving credit facility. Total debt at September 30 was \$695 million with no senior note maturities until fiscal 2026 and our net debt-to-capital ratio was 5.5%. We ended the quarter with \$1.4 billion of stockholders' equity, and our book value per share increased 14% from a year ago to \$27.43.

Forestar's capital structure is one of our biggest competitive advantages, and it sets us apart from other land developers. Project level land acquisition and development loans are less available today and have continued to become more expensive, which impacts the majority of our competitors. Other developers generally use project-level development loans which are typically more restrictive, have floating rates and create administrative

complexity, particularly in a rising rate environment. Our capital structure provides us with operational flexibility while our strong liquidity positions us to take advantage of attractive opportunities when they arise.

Dan, I will now turn it back over to you for closing remarks.

## **Daniel Bartok**

Thanks, Jim. We are pleased with the Forestar team's execution during fiscal 2023, delivering strong profitability and maintaining double-digit returns. Thank you to all the Forestar team members for your efforts this year.

The fourth quarter was especially strong with our delivery of almost 5,000 lots. The variability we experienced throughout fiscal 2023 illustrates the quarter-to-quarter fluctuations that can occur in the demand and the delivery of finished lots. It also illustrates Forestar's ability and its flexibility to adjust to market changes. The current interest rate environment and market factors create a challenging backdrop as we position the company for the next several years of increasing market share.

As we look forward to fiscal 2024, based on current market conditions, we currently expect to deliver between 14,500 and 15,500 lots and generate \$1.4 billion to \$1.5 billion of revenue. We are closely monitoring each market as we strive to balance pace and price to maximize returns in each project.

We are the market leader in a highly fragmented and undercapitalized industry and we are uniquely positioned to take advantage of builder demand for finished lots. Our goal remains the same, to double our market share to 5% over the intermediate term. We will continue to aggregate significant market share over the next few years while maintaining our disciplined approach in investing capital to enhance the long-term value of Forestar.

We have a track record of solid execution and will utilize our platform and strong balance sheet to capitalize on opportunities that build shareholder value. With our experienced team that has successfully managed through prior market cycles, we are well equipped to navigate this dynamic environment while investing for our future growth and further strengthening our industry-leading position.

John, at this time, we'll open the line for questions.

## **Question-and-Answer Session**

### **Operator**

Thank you. [Operator Instructions] The first question comes from Carl Reichardt with BTIG. Carl, please proceed.

### **Carl Reichardt**

Thanks, everybody. So I think if I heard you guys right, you're looking at land spend or -- and plus development spend next year that's up 50% -- more than 50% from this last fiscal year. I was wondering if you could talk a little bit about the split between new lots versus investing development on existing lots. And if there could be any significant alterations in terms of the geographic mix, new markets or just leaning in one direction in markets that you're already in.

### **Daniel Bartok**

Yes, we're seeing some significant opportunities right now, and we expect that our land spend will increase pretty significantly over last year. I mean our last quarter was probably more reflective of what you'll see from land spend. As far as the actual split between development costs and land spend, I don't know that I really have that breakout, but we do expect to use some of our liquidity to increase our balance sheet this year.

As far as markets that we're in, most of what we're doing is building depth within the markets that we're in. We've got the teams in place. We'll continue to make investments in team as we build out our platform. But I don't really see us opening up a lot of new markets. I think you'll see on this one, we re-entered Seattle this year -- this last quarter, and then we actually did a deal in West Virginia in the western suburbs of D.C. there.

So we have entered a couple of new markets or at least re-entered one and entered a new one, and there'll probably be one or two more of those that we probably re-enter. Again, I think most of our focus is going to be on continuing to build market share in the markets that we're already in, Carl.

**Carl Reichardt**

Okay. And then, Jim, you've said this before, you've all said this before, the fluctuation in average revenue per lot or lot prices. And we know it's going to bounce around. Could you give us some type of lower bound and upper bound of the kind of numbers that we might expect based on the lots that you're anticipating on delivering in '24 or even just the pipeline that you have delivering in '24 or beyond?

**James Allen**

I don't know that we really have that. I mean our lot -- average lot price does bounce around. It's because we underwrite and focus on returns as opposed to margins. There's always going to be changing lot prices and margins due to mix, whether it's geographic or lot size mix. But I don't know that I can give you a real range. I mean you can see the range we've had this year, even from last quarter to this quarter is pretty -- can be pretty significant.

**Daniel Bartok**

Yes. I'll add a little bit. What's interesting is when you look back at the year versus any individual quarter, Carl, our ASPs this year for the year was up about 6% or 5% from the prior year. And then last year, it was up about 5% or 6% from the year before that. If I was doing the chart, I would probably assume something in that range for next year. But again, it could fluctuate clearly, from quarter-to-quarter, it's going to fluctuate based on what we're doing in a given market, but over a year that's probably right.

**Carl Reichardt**

Okay. That was my default, if you didn't answer it. And then if I could sneak one more in. So the guidance on deliveries for '24 sort of matches up more or less with your biggest customer in terms of their delivery volume. Obviously, there's timing differentials, and I know that. So is that basically to say that you expect that outside of your largest customer in terms of sales to other builders, you'd grow them at a similar rate as to what you grow your business to D.R. Horton? Or do you expect that mix to fluctuate more distinctly in 2024 in terms of expanding that base since I know you want to do that?

**Daniel Bartok**

Yes. At this point, looking at the year in front of us, I would assume that it's going to stay, the mix is going to stay pretty much the same to be honest with you. I think we're getting a lot more interest from other builders as I think their development partners are also having difficulty getting financing. But overall, when I look at the lots that we'll be delivering in '24, that's all stuff we own already and in development. So I would expect that, that pro rata share would stay pretty flat.

**Operator**

The next question comes from Truman Patterson with Wolf Research. Please proceed.

**Truman Patterson**

Hey, good afternoon everyone. I apologize, my phone has been cutting out. So if this is a duplicate. But I did want to follow up on one of Carl's questions. When we're looking at your fiscal fourth quarter lot pricing, it increased like 10% year-over-year to \$97,000. And if I'm looking at your '24 guide, looks like ASPs remain at that level moving forward. Is there any geographical mix shift or perhaps consumer mix shift? I'm thinking larger lots more of a move-up focus or is this kind of a true pricing power that you're currently recognizing?

**Mark Walker**

Yes. I think it's true pricing power. I mean with inflationary costs are going up, obviously, it's market by market, community by community, again, geography and just the mix of the lots themselves. But we are again pricing

our lots to market and trying to phase our deliveries in tune, but if we can grab additional returns, we'll go out and grab additional returns. But I don't think it's anything particular to lot size sell for the fourth quarter, geography.

**Daniel Bartok**

I think fourth quarter is mostly geography. That spike is not a run rate. It was clearly a mixture of some more expensive lots.

**Truman Patterson**

Okay. Okay. Got you. And then just looking at your closings range of 14.5 to 15.5 lot sales. Trying to understand what would get us towards kind of the lower end or the higher end of that range. And I'm thinking really whether there are any development or muni delays that are kind of built into this or if it's just purely a function of market demand and potentially changing interest rates or anything along those lines?

**Daniel Bartok**

Yes. I mean I think low end, we're going to continue to -- the focus on returns and making sure that we're moving lots and that the subdivisions are active. The interest rate environment out there today makes it a little challenging to guess how the rest of the year is going to play out. But I think we've made our best guess. I think we've taken, what our knowledge is of the difficulties in different municipalities into account as we do our forecast.

So I feel good about that range. The upside could be, I think we'll have the lots under development and a strong finished lot inventory that if, for some reason, rates come down and home sales accelerate, I think we'll be in a position to definitely be at the high end of that range.

**Truman Patterson**

Okay. Perfect. And if I could squeeze one more in. You all brought up value engineering, your lot positions. Could you just elaborate on that a little bit?

**Mark Walker**

Yes. As we go through and plan our projects, we're looking to be as efficient as possible with timing and cost. So looking to value engineer basically our plans upfront for better cost, but also for -- and we've been very disciplined in phasing our developments and remain very flexible to be able to turn on more developments or increase -- to step on the gas within an existing development or if we need to take our foot off the gas.

But from a value engineering standpoint, it's really related to calls and timing. But we look at that on every project and when we're going through due diligence, even after we own an asset as we phase an asset. So it's something that the teams are doing day in, day out.

**Operator**

Up next, we have Mike Rehaut with JPMorgan. Please proceed.

**Douglas Wardlaw**

Hi guys, good afternoon. Doug Wardlaw on for Mike. You guys mentioned throughout this call, your advantage in this industry as other competitors don't have the same kind of scale as you've got. And I was wondering if you can give any -- what kind of trends you saw throughout the quarter as the kind of rate volatility progressed throughout the summer, any trends that you saw? In addition to that, what you're expecting, at least in the early stages of 2024 maybe likely continued rate volatility?

**Daniel Bartok**

You're a little fuzzy on the speaker here, but are you looking more from a lot demand standpoint or from a development competition standpoint?

**Douglas Wardlaw**

More so from a development competition standpoint.

**Daniel Bartok**

Well, we're definitely seeing opportunities where other developers are having a hard time getting financing in place and their cost of that financing has run up. So potentially either deals that they've tied up that they can now not close on or get developed or literally their banks are saying, no more. I think we saw more of that this last quarter than we did in prior quarters. And it feels like a trend like maybe it will continue to be a little bit more difficult while we have a high interest rate environment and the banks are nervous. But we're definitely seeing -- at least from our standpoint, we're seeing more opportunities to pick up positions that other people can't perform on.

**Operator**

The next question comes from Anthony Pettinari with Citi. Anthony, please proceed.

**Anthony Pettinari**

Hey, good afternoon. On the full year guide, I'm just -- from a big picture perspective, I don't think you've provided full year guidance for the past maybe four or five quarters. Can you talk about what's giving you confidence now in terms of giving the next year outlook given we still have a fair amount of rate volatility and macro uncertainty?

**Daniel Bartok**

I think I'd attribute to a couple of things. Last year, between still a lot of supply chain problems and understanding what was happening at the municipal levels for -- to get kind of final sign-offs and deliveries, I feel like that has leveled off or at least we have a better understanding of what those impacts are. Where last year, it was a little bit of a wild guess, which is why we didn't give guidance. The other is the interest rate environment.

At this point, if you would have told me that builder sales would still be this strong when mortgage rates are approaching 8%, I would have probably laughed at you and yet the market thinks the builders continue to be selling homes and finding the right market price. So I think that I feel like there is that little bit more consistency in the builders being able to deliver even in this higher interest rate environment. So I think both of those things make us feel pretty good about giving that guidance at this point.

**Anthony Pettinari**

Okay. That's very helpful. And then just in terms of the full year guide, understanding the business is choppy. Is there a way to think about kind of quarterly cadence of deliveries implied in the full year guide? Is there any kind of seasonal dynamic that we should kind of keep in mind? Or any kind of specific cadence kind of baked into your current contracts?

**Daniel Bartok**

It's really hard to put any kind of a guess on that. But the one thing I would say, when I look back the last few years, our fourth quarter has always seemed to be the better quarter. But I don't know that it's contractually any reason for that or how lots are being delivered. It's just -- again, it feels like the -- when you look back and try to analyze the numbers, there appears to be a trend there. But it really varies. I mean, just look at the last 4 quarters of this year, how different one quarter was to the next. I wouldn't be able to give you a good cadence.

**Operator**

We have reached the end of the question-and-answer session. And I will now turn the call over to Dan Bartok for closing remarks.

**Daniel Bartok**

Thank you, John. And thanks to everyone on the Forestar team for your focus and hard work as we enter fiscal 2024, continue to stay disciplined, flexible and opportunistic, while focusing on consolidating market share. We appreciate everyone's time on the call today and look forward to speaking with you again in January to share our first quarter results. Thank you.

**Operator**

This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.