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D.R. Horton, Inc. (DHI) CEO David Auld on Q4 2019 Results - Earnings Call Transcript

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FQ4: 11-12-19 Earnings Summary

Press Release SEC *10-K* *Slides*

EPS of $1.35 beats by $0.10 | Revenue of $5.04B (11.85% Y/Y) beats by $178.56M

Earning Call Audio

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D.R. Horton, Inc. (NYSE:DHI) Q4 2019 Results Conference Call November 12, 2019 8:30 AM ET

Company Participants

Jessica Hansen - VP, IR

David Auld - President and CEO

Mike Murray - EVP and COO

Bill Wheat - EVP and CFO

Conference Call Participants

John Lovallo - Bank of America

Alan Ratner - Zelman and Associates

Carl Reichardt - BTIG

Truman Patterson - Wells Fargo

Eric Bosshard - Cleveland Research

Stephen Kim - Evercore ISI

Matthew Bouley - Barclays

Michael Rehaut - JP Morgan

Megan McGrath - Buckingham Research Group

Jack Micenko - SIG

Mark Weintraub - Seaport Global

Ken Zener - KeyBanc Capital Markets

Alex Barron - Housing Research Center

Operator

Good morning and welcome to the Fourth Quarter 2019 Earnings Conference Call for D.R. Horton, America's Builder, the largest builder in the United States. At this time, all participants are in a listen-only mode. An interactive question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Jessica Hansen, Vice President, Investor Relations for D.R. Horton. Thank you. You may begin.

Jessica Hansen

Thank you, Melissa, and good morning. Welcome to our call to discuss our fourth quarter and fiscal 2019 financial results.

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 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 and our subsequent quarterly reports on Form 10-Q, all of which are filed with the Securities and Exchange Commission.

This morning's earnings release can be found on our website at investor.drhorton.com and we plan to file our 10-K next week. After this call, we will post updated investor and supplementary data presentations to our Investor Relations site on the Presentations section under News & Events for your reference.

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

David Auld

Thank you, Jessica, and good morning. In addition to Jessica, I'm pleased to be joined on the 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 finished the year strong. Pretax income for the fourth quarter increased 9% to $660 million on $5 billion of revenue and our pretax operating margin was 13.1%. For the year EPS increased 13% to $4.29 per diluted share and consolidated pretax income increased to $2.1 billion on $17.6 billion of revenues. Our consolidated pretax margin for the year was 12.1%. We closed 56,975 homes this year, an increase of over 5,000 homes or 10% from last year. Our homebuilding return on inventory was 18.1% and our return on equity was 17.2%. These results reflect the strength of our operational teams, our ability to leverage D.R. Horton scale across our broad geographic footprint and our product positioning to offer homes at affordable price points across multiple brands.

Our homebuilding cash flow from operations in 2019 was $1.4 billion. Over the past five years, we have generated approximately $4 billion of cash flow from homebuilding operations while growing our homebuilding revenues by more than $9 billion or 117% and our earnings per share by 186%. During these five years in addition to organically growing the business, we have invested approximately $1 billion on acquisitions and returned over $1.4 billion to shareholders through dividends and share repurchases, while reducing homebuilding debt by $1.3 billion.

As a result, our return on equity increased by 540 basis points, while our homebuilding debt to capital ratio decreased by less than half of its level five years ago. Our strategic focus is to continue consolidating market share while growing both our revenues and pretax profits, generating strong cash flows and returns, and maintaining a flexible financial position with a conservative balance sheet that includes an ample supply of homes lots and lands to support growth and a good October sales base, we're well-positioned as we begin 2020.

Mike?

Mike Murray

Diluted earnings per share for the fourth quarter of fiscal 2019 increased 11% to $1.35 per share compared to $1.22 per share in the prior year quarter. Net income for the quarter increased 8% to $505 million compared to $466 million. Our consolidated pretax income increased 9% to $660 million in the fourth quarter from $608 million, and homebuilding pretax income increased 3% to $594 million from $578 million. Our fourth quarter home sales revenues increased 10% to $4.8 billion on 16,024 homes close, up from $4.4 billion on 14,674 homes closed in the year ago quarter. Our average closing price for the quarter was $299,500, flat with the prior year.

Bill?

Bill Wheat

Net sales orders in the fourth quarter increased 14% to 13,130 homes, and the value of those orders was $4 billion, up 16% from $3.4 billion in the prior year. Our average number of active selling communities increased 9% from the prior year and was flat sequentially. Excluding the builders we acquired earlier this year, our fourth quarter net sales orders were up 11% and our average number of active selling communities increased 2%. Our average sales price on net sales orders in the fourth quarter was $302,300, up 1% from the prior year. The cancellation rate for the fourth quarter was 23%, down from 26% in the same quarter last year.

Jessica?

Jessica Hansen

Our gross profit margin on home sales revenue in the fourth quarter was 21%, up 70 basis points sequentially from the June quarter. The sequential increase in our gross margin from June to September exceeded our expectations and was primarily due to lower sales incentives. Based on today's market conditions, we currently expect our home sales gross margin in the first quarter to be consistent with the fourth quarter, subject to possible fluctuations due to product and geographic mix, as well as the relative impact of warranty, litigation and purchase accounting.

Bill?

Bill Wheat

In the fourth quarter, SG&A expense as a percentage of homebuilding revenues was 8.5% compared to 8.4% from the prior year quarter. The increase in our fourth quarter SG&A year-over-year was primarily due to compensation accruals related to increases in our stock price. For the full year, homebuilding SG&A was 8.7% compared to 8.6% in 2018. We did not achieve SG&A leverage this year after we lowered our revenue growth expectations in our fiscal first quarter and worked to align our inventory levels and operations with our revised expectations throughout the year. We remain focused on controlling our SG&A while ensuring our infrastructure adequately supports our growth and we expect to improve our SG&A rate in 2020.

Jessica?

Jessica Hansen

Financial services pretax income in the fourth quarter was $61 million and the pretax operating margin was 44.8%. For the year, financial services pretax income was $166 million on $442 million of revenues, representing a 37.6% pretax operating margin. 97% 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 63% of our homebuyers.

FHA and VA loans accounted for 48% of the mortgage company's volume. Borrowers originating loans with the DHI Mortgage this quarter had an average FICO score of 720 and an average loan to value ratio of 89%. First time homebuyers represented 50% of closings handled by our mortgage company, up from 49% in the prior year quarter, reflecting our continued focus on offering homes at affordable price points for entry level buyers.

Mike?

Mike Murray

We ended the year with 27,700 homes in inventory, essentially flat with last year 16,000 of our total homes were unsold, of which 5,200 were completed. Our fourth quarter homebuilding investments in lots, land and development totaled $990 million out of which $610 million was to replenish finish lots and land and $380 million was for land development. For the year, we invested $3.7 billion in lot, land and development.

David?

David Auld

At September 30th, our homebuilding lot position consisted of approximately 307,000 lots of which 40% were owned and 60% were controlled. 30% of our total owned lots are finished and at least 54% of our controlled lots are or will be finished when we purchase them. We continue working to increase our lot position being developed by third parties by supporting the growth of Forestar's national lot manufacturing platform and expanding our relationships with lot developers across the country. Our current lot portfolio includes an ample supply of lots for homes at affordable price points and continues to provide a strong competitive advantage.

Mike?

Mike Murray

Forestar, our majority owned subsidiary is a publicly-traded residential lot manufacturer, now operating in 51 markets across 20 states. At September 30th, Forestar's lot position consisted of 38,300 lots of which 29,700 are owned and 8,600 are controlled through purchased contracts. 79% of Forestar's owned logs are already under contract with D.R. Horton or subject to a right of first offer under the master supply agreement.

Forestar exceeded its guidance for this year by delivering 4,132 lots and generating $428 million of revenue for its fiscal year ended September 30th. Forestar expects to deliver 10,000 lots and generate $750 million to $850 million of revenue in fiscal 2020 and to deliver 12,000 lots and generate $900 million to $1 billion of revenue in fiscal 2021. These expectations are for Forestar's standalone results.

Forestar's making steady progress in building its operational platform and capital structure to support its significant growth plans. During the quarter, Forestar issued approximately $6 million of its common stock in a public offering. Net proceeds from this offering were approximately $100 million which will help support Forestar's future growth. After the issuance, D.R. Horton's ownership percentage of Forestar decreased from 75% to approximately 66%.

Forestar plans to opportunistically access the capital markets as necessary to provide additional capital for long-term growth. Forestar is separately capitalized from D.R. Horton and is targeting a long-term net debt to capital ratio of 40% or less.

We are excited about Forestar's growing operating platform and the value this relationship will create over the long term for both D.R Horton and Forestar's shareholders.

David?

David Auld

DHI Communities is our multifamily rental company, focused on suburban garden-style apartments with current operations primarily in Texas, Arizona and Florida. DHI Communities currently has four projects under active construction and two projects that were substantially complete at the end of the quarter, one of which was on a contract to sell at September 30th. During 2019, DHI Communities sold two multifamily rental properties for $133,400,000 and recorded a gain on sale of $51.9 million. DHI Communities' total assets were $204 million at the end of the year. We expect DHI Communities assets to increase significantly in 2020 as its pipeline of multifamily rental projects grows. We also expect to sell two rental properties in 2020.

Bill?

Bill Wheat

Our balanced capital approach focuses on being flexible, opportunistic and disciplined. Our balance sheet strength and operating results have increased our flexibility and we are utilizing our strong position to enhance the long-term value of the Company. During fiscal 2019, cash generated by homebuilding operations was $1.4 billion, bringing our cumulative cash generated from homebuilding operations for the past five years to approximately $4 billion. At September 30th, we had $2.2 billion of homebuilding liquidity, consisting of $1 billion of unrestricted home building cash and $1.2 billion of available capacity on our revolving credit facility.

Our consolidated leverage improved 100 basis points from a year ago to 25.3%. And homebuilding leverage improved 440 basis points to 17%, the balance of our homebuilding public notes outstanding at fiscal year-end was $1.9 billion and we have $500 million of senior note maturities due in the next 12 months.

Subsequent to year-end, we issued $500 million of 2.5% senior notes due in 2024. We also extended the maturity date of our revolving credit facility by just over a year and increased its capacity to $1.59 billion. At September 30th, our stockholders' equity was $10 billion, and book value per share was $27.20, up 14% from a year ago.

During the quarter, we paid cash dividends of $55.5 million and repurchased 2.1 million shares of common stock for $104.3 million. For the year, we paid cash dividends of $223.4 million and repurchased 11.9 million shares of common stock for $479.8 million. As a result of our share repurchases this year, we reduced our outstanding share count by 2% compared to a year ago.

The Company's remaining stock repurchase authorization at September 30th was $895.7 million with no expiration date. Based on our financial positions and outlook for fiscal 2020, our Board of Directors increased our quarterly cash dividend by 17% to $0.175 per share. We currently expect to pay dividends of approximately $250 million in fiscal 2020.

Jessica?

Jessica Hansen

Looking forward to the first quarter of fiscal 2020, we expect to generate consolidated revenues of $3.7 billion to $3.8 billion and our homes closed to be in a range between 12,100 and 12,400 homes. We expect our home sales gross margin in the first quarter to be approximately 21% and homebuilding SG&A in the first quarter to be around 9.5% of homebuilding revenues. Based on today's market conditions, our expected growth for fiscal 2020 is still in the mid to high single digit percentage range for both consolidated revenues and homes closed. We currently expect to generate consolidated revenues for the full year of $18.5 billion to $19 billion, and to close between 60,000 and 61,000 homes.

We are forecast an income tax rate for fiscal 2020 of approximately 25%, and we expect to reduce our outstanding share count by approximately 2% at the end of fiscal 2020, compared to the end of fiscal 2019. We also expect to generate homebuilding cash flow from operations in excess of $1 billion, again during fiscal 2020.

David?

David Auld

In closing, our results reflect the strength of our well-established operating platform across the country. We are focused on consolidating market share while growing our revenues and profits and generating strong annual cash flows and returns while maintaining a flexible financial position. We are well-positioned to do so with our conservative balance sheet, broad geographic footprint, affordable product offerings across multiple brands, attractive finished lot and land position, and most importantly, our outstanding experienced team across the country. We congratulate the entire D.R. Horton team on closing the most homes in a year in company history, and we thank you for your hard work and accomplishments. We're incredibly well-positioned to continue growing and improving our operations in 2020. This concludes our prepared remarks. We will now host questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of John Lovallo with Bank of America. Please proceed with your question.

John Lovallo

Hey, guys. Thank you for taking my question. I guess, first of all, the cash flow from operations target of greater than $1 billion could be interpreted as being somewhat conservative, given the 2019 performance of $1.4 billion, and what appears to be set up here for improved profitability in fiscal year ‘20. What do you see kind of as the biggest variables here? And is there any reason that you can point to why cash flow would be lower on a year-over-year basis?

Bill Wheat

John, we expect to generate consistently strong cash flow in excess of $1 billion. Year-to-year that number can move around a little just depending on timing of investments and homebuilding, and given that were early in the year and we want to see how demand goes through the year that could impact our investment levels in the business. So, a greater than $1 billion is certainly a solid range and that gives us flexibility then as we move through the year and we’ll update that estimate as we need to.

John Lovallo

Okay. That makes sense. And then, last year, I think, you guys outlined potential acquisition target range of $400 million to $600 million. How are you guys thinking about that heading into 2020 and what does the pipeline look like?

Bill Wheat

We’re still actively looking at some opportunities, John. But, we're very selective and wanted to be very targeted in what we're doing there. So, while we're looking at some, they’re very hard to predict when they are actually going to happen. This year, we don’t have that same level of clarity to a number that we had at this time last year.

Operator

Thank you. Our next question comes from the line of Alan Ratner with Zelman and Associates. Please proceed with your question.

Alan Ratner

Hey, guys. Good morning. Congrats on a strong close to the year. So, my first question, I’ve always kind of thought about the homes and inventory data point that you guys provide is a little bit of leading indicator in terms of how you see the business growing over the next few quarters. And, I think, this is the first quarter in a while where you’ve actually been down a bit on a year-over-year basis. And I'm just curious, as you think about that mid to high single digit growth targets in 2020, should we start to see that number move higher or is there any kind of change in the way you're thinking about having specs on the ground and homes in inventory, and maybe any shifts in demand for to-be-built homes versus spec that would be potentially driving that number lower than I would have suspected?

Bill Wheat

I think, Alan, we're seeing it, similar breakdown between our to-be-builts and our available homes that we have in inventory. But, we're excited, looking at going into this year with a good demand environment and opportunity continue improving our returns and part of the way we've talked about last quarter of improving returns is to focus on improving our home inventory turnover. And so, that's something we're excited about the opportunity to deliver on in fiscal '20.

Alan Ratner

And then, I guess, just a follow-up on that but implied there I guess is you are still confident that you can maintain the very high backlog conversion rates that you've delivered in the past and while keeping a lower inventory level, and in total, is that the way to interpret that?

Bill Wheat

I think you will see our inventory level increase from where we are at this point in the year. But, we're looking to be more efficient with the capital. So, we look to see a higher overall turnover rate.

Alan Ratner

Okay. That's helpful. And if I could just ask one more. Investors, obviously, have been very focused on the 10-year treasury yield, which has been climbing off of recent lows off late and still incredibly low levels from an absolute standpoint. But, you mentioned the strong sales environment in October, which obviously coincides with that move up we've seen in recent weeks. How do you see the rate environment today? I mean, is there any -- would you see maybe pull forward from buyers that are trying to jump in before rates continue to move higher? Is it not a concern at all of yours in the marketplace? Any commentary you can give just in terms of what you're thinking about are seeing on the ground from the rate environment would be helpful.

David Auld

I think, anything that impacts affordability is always going to be a concern. I will say, when you look at what drives homebuilding, which is job growth and overall economy, we feel very, very good about what's happening there. And homes, they're affordable as they're going to get. I do think yes, there may be a little bit of pull forward demand. But, right now, the market feels really, really good.

Jessica Hansen

And Alan, it’s one positive came out of last year at this time, and what we experienced, it was a renewed focus in the field for us to stay and make sure we have this affordable product offering, kind of regardless of what interest rates are doing. So, we continue to see our average square footage come down slightly. It was down about 3% on a year-over-year basis again. And we've proactively gotten the houses out there that we believe are affordable in today's market and will continue to adjust as necessary to whatever rate environment we find ourselves in. But, clearly, today is a little bit better rate environment than it was last year at this time.

Operator

Thank you. Our next question comes from the line of Carl Reichardt with BTIG. Please proceed with your question.

Carl Reichardt

Thanks. Good morning, all. I wanted to ask David a little bit about the competition especially for entry level in terms -- lots in particular, number of your peers are making a move in the direction that you made some time ago. And you've had a couple of smaller peers talk about how it's been harder to find assets out but they'd like to build smaller homes. Can you talk a little bit about what you're seeing competitively? Obviously, the lot supply is what it is and it’s strong, but you'll be looking for more, they'll be more looking in the same area as you are. So, I was just curious as to your thoughts there.

David Auld

Carl, we compete every day. And yes, I do think that you’re seeing more people attempt to get lower in price point and drive better affordability. But again, like we've talked about in the past, our positions are very long, very deep. And we don't intend to give up market share and that -- so that’s servicing that bar.

I will say, demand is still very, very deep. And I think, from my travels that supply is still tight, especially as you achieve true affordability, so. But, we take a lot of comfort in the fact that we've got a long runway and very affordable position, deep and long, so.

Carl Reichardt

Thanks, Dave. And then, Bill, I want to follow up on Alan's question about inventories. I think, we made a few reclassifications to what's unsold versus we move models I think, but thinking back I think three years ago or so where you entered the year, feeling like you were short a little bit of inventory and it hurt you from a delivery perspective, I just want to make sure you are not feeling that way now, you feel comfortable the inventory you got in the ground as you head into this first quarter, is there -- and you're not feeling the same way that you did three years ago.

Mike Murray

Paul, this is Mike. And I would say, it's different from three years ago that not just we feel really good about the focus we've had on housing turns and how to improve that as well as having lots on the ground to support the starts that we'll need to be making over this quarter to support what we hope to be really robust spring selling season. So, three years ago, we were struggling not just with the inventory levels of housing, but also with our finished lot positions behind that.

Jessica Hansen

And we feel very comfortable with the 60,000 to 61,000 annual target, but the reason we right now wouldn't say we're comfortable moving higher than that for this next fiscal is because where we're starting from a homes' perspective. So, 60 to 61, we feel very comfortable with.

Operator

Our next question comes from the line of Truman Patterson with Wells Fargo. Please proceed with your question.

Truman Patterson

First, I wanted to touch on the SG&A. It came in a little bit above your guidance. Could you just walk us through the drivers of this and how we should think about incremental SG&A going forward? I'm really thinking about 2020. You mentioned some leverage. But, you guys are guiding mid to high single-digit revenue growth, which is pretty much what you all did in 2019 and your SG&A was kind of flattish. Could you kind of break it out why 2021 would improve while 2019 didn't necessarily tick down?

Bill Wheat

Sure. Truman, this is Bill. Specifically, in the fourth quarter when we missed our guidance, that was specifically due to some of our compensation accruals are tied to changes in our share price. And as our stock price increased pretty sharply in the fourth quarter, we had to increase a number of those accruals, and that entirely accounts for the miss versus our guidance for the Q4 SG&A rate.

As you look back over the full year of '19 and as we look forward to '20 though, it's a little bit of a broader discussion. As you recall, in fiscal 2019 at the start of the year, we had expectations to grow more to double-digit pace. But then, very early in the year as we saw softer market in the first quarter, we lowered our revenue expectations. But, we had our infrastructure in place and homes in place, homes and inventory obviously to support a higher revenue number. So, really throughout this year, we've been working to adjust our inventory levels and our operations to kind of fit that lower revenue expectation. And we've been running typically about 10 basis points higher than the prior year all year along.

As we go into fiscal 2020, while we have the same revenue expectations that we ultimately achieved in '19, we feel like our positioning is appropriate for that revenue. And with mid to high single-digit revenue growth, we should see SG&A leverage. And so, we do expect to improve on our SG&A rate versus 2019 as we go into fiscal 2020.

Truman Patterson

Okay. Thanks for that. And then, on the financial services side, I think, it's the best result you guys have had in history. Could you just walk us through the drivers of this, and possibly, how sustainable it is going forward?

Jessica Hansen

Sure. Truman, it was mainly due to favorable market conditions just because of low interest rate environment. So, that was by far the strongest driver. And our mortgage company though has also done a fantastic job working on becoming more efficient, they've improved their capture rate. I think, 63% this quarter was one of the highest we've seen in quite some time. But, normal historical operating margin is more in the 30% range, the low 30s. And we do anticipate that's what they're ultimately going to return to. But, no question this year was a very strong performance for that business.

Operator

Thank you. Our next question comes from the line of Eric Bosshard with Cleveland Research. Please proceed with your question.

Eric Bosshard

Good morning. A question on gross margin, as you look at price and incentives and gross margin, curious how you would compare your thinking for the coming year relative to the year you just completed?

Bill Wheat

I think, we're going to see frankly, Eric, more the same. We see lower levels of incentives than where we've been sequentially through the year, margins have come up nicely, as we walk from the second quarter low that we've had. We've been very intentional about trying to manage that to drive the best returns. And looking into fiscal 2020, as clear as plan all shows, this -- we're expecting margins to be about flat kind of where we've been in the fourth quarter.

Eric Bosshard

And then, secondly, in terms of Forestar and option, can you talk about the progress you've made and where that number is going, and how it's going, you would -- how you would characterize how it's going?

Mike Murray

Overall, we feel really well about the progress we've made to get to 60%. I know that's a little bit bouncy quarter-to-quarter. And we've talked about, it's a dynamic number that measured in any quarter and it's going to move a little bit directionally. I hope to get a little more progress on that this year, and the trend continues. Forestar continues to add to their operating platform, add their team, which is a great first source for us, for a third-party developer. And at the same time, we work really hard developing relationships with other third-party developers as well, and continuing to expand those relationships that we have in various markets. And getting people in markets, we have not historically been able to get developers to step in and complete lots for us. It's an ongoing, long-term process.

Eric Bosshard

And the destination ultimately, the 60%, where would you like that number to get to and over what time frame?

Mike Murray

Hard to say, an ultimate number, higher than where it is today. But it's something we'll probably be working at very hard for our entire careers here at D.R. Horton.

Eric Bosshard

Thank you.

Operator

Thank you. Our next question comes from the line of Stephen Kim with Evercore ISI. Please proceed with your question.

Stephen Kim

Yes. Thanks very much, guys. Mike, just wanted to clarify one thing, you just said I think with respect to margins in 2020 that you're thinking you could probably be flat with where you were in 4Q '19. So, in other words, kind of around that 21% gross margin in 2020 is kind of what you're thinking. Right?

Mike Murray

Yes, sir.

Stephen Kim

Okay, great. I just wanted to clarify that. That's great. The second question relates to SG&A. So,

I believe, Bill, you were talking about the impact of the stock-based compensation in 4Q, your September quarter, you made adjustment to your accruals for the higher stock price. I was wondering if -- there shouldn't be any lingering impact from that. Let's say, if your stock price would remain flat into next year, should there -- the reason I'm asking is because 1Q guide on SG&A is for flat, even though your closings are up about 7%, just kind of like what you're thinking for the year. So, just trying to figure out why we wouldn't seem a little more leverage in 1Q, like you're expecting to see for the full year?

Bill Wheat

Right. Yes, the change in the accrual should not have any lingering effect that you are correct in that assumption. As we look at our absolute level of SG&A spend going into the first quarter along with our revenue guide, we believe 9.5% is the level that we feel like we will be at. If you do go back a year ago though if you're comparing year-over-year, in the first quarter, we had some, I hate to say benefit, but we did have some benefit from a reduction in our stock price last year. So, some of those accruals were pulled down a year ago in the first quarter. So, it’s simply timing on that basis, but it does move the needle a bit. It can move to 10 to 20 basis points.

Stephen Kim

Got it. Yes. That's very clear. And then, lastly, I think, in your opening remarks, you talked about October off to a strong start. I was just wondering if you could give us a little bit more. Are we seeing in any way an acceleration into October in anyway, either in terms of being able to reduce incentives at a more aggressive pace or any other kind of color you can provide around the demand environment in October?

David Auld

This October feels so much better than last October…

Stephen Kim

Sure.

David Auld

It's hard not to be a little bit excited about what the year brings. I can tell you we're not thinking that we're going to see a margin expansion because I do believe there is going to be more competition. But, where we see the business right now today is very, very solid and feel comfortable, at least today with sharing that -- we are looking for pretty flat margins going forward. As you know, we're not typically the most optimistic group out there.

Stephen Kim

Right, but just the hardest working. I appreciate it, guys.

David Auld

Yes, sir.

Operator

Thank you. Our next question comes from the line of Matthew Bouley with Barclays. Please proceed with your question.

Matthew Bouley

I want to start with the question on the Q1 gross margin guide consistent with Q4. Can you just go through some of the sequential puts and takes in that? So, I guess, what are you guys assuming around incentives and direct costs, and perhaps if there is any purchase accounting that's still rolling off?

Jessica Hansen

It’s really just looking at kind of our core lot level gross margin and assuming all else remains equal, so really no impact, one way or another from warranty and litigation or interest or property taxes. Now, those can move the needle quarter-to-quarter but they are really hard to project. So, right now, they are approximately 21%, would assume those are relatively in the same range as they were in Q4. And then, we're able to maintain a flat pricing environment or a pricing environment that is increased at the same level as our cost. So, that’s what we saw this quarter sequentially -- well, actually sequentially we saw an improvement because of the continued pullback on incentives, which we think we're through the most of. But, our revenues per square foot were up about 2%, stick and brick costs were up about 1%.

Matthew Bouley

Okay. Thank you for that color, Jessica. And then, I want to ask about some of the regional trends as well because it looked like the South Central really accelerated. So, any elaboration if you guys are sort leaning into Texas again. You guys have seemingly pulled back a bit there the past couple of quarters. And then, I guess, any color on the West and California as well?

Mike Murray

So, I think -- let me take second part of your question first. California and the west, we're seeing good sales trends out there. We've kind of refocused ourselves on maintaining affordability. And at the price points, we're offering our teams out there doing a great job executing for those buyers. And we're seeing the buyers respond.

In Texas, it's home. We've been dominating here for a long time and we will continue to do so. And those communities are performing exceptionally well, great teams on those projects. And the economy is strong here. And the interest rate adjustments, as David mentioned before, helps affordability. But, we have always been focused on meeting that affordable need in the State of Texas. And we're seeing great response.

David Auld

I'll just add that a lot of it's positioning. And I think coming into this year, we feel very good about the way we're positioned, and both really California with the price that we've been able to drive down to and in Texas with lots out in front of our building operation.

Operator

Thank you. Our next question comes from the line of Michael Rehaut with JP Morgan. Please proceed with your question.

Michael Rehaut

Hi. Thanks. Good morning, everyone. First question I had was on how you're thinking about growth next year. And what I mean by that, obviously you gave the guidance, much appreciated, and in line with your prior expectations. But, if you go back over the last 5, 10 years, you've had a couple of different initiatives that I think have really been extremely helpful in driving the growth and taking share around the Horton Express around the Emerald. I think, you've talked in the past about other strategic goals to allow for a consistent growth going forward, including the Freedom Homes, the active adult, maybe even getting deeper in the East footprint as areas of opportunity. I was curious, as you look over the next year or two, how prominent those areas of strategic focus will be or the role that it will play in allowing you to continue to reach higher heights? Obviously getting to 60,000, you are up now consistently for the last three or four years, you are going up, 4,000, 5,000, 6,000 closings per year. So, I was just curious, as you look at the next year or two, achieving the next ladders up of growth, is that going to be more broad-based, this kind of market driven or do you see specific games in some of those strategic initiatives that you've talked about in the past?

David Auld

I think, on the last call, Bill talked about the fact that we're only top 5, and -- yes, number 1 in 13, top 5 in 30, 32 markets. So, we've got a lot of -- a lot of runway in those markets. And as to the brands, we're trying to drive optionality for the buyers and to create a focus and product to meet everybody's needs in the market. So, I feel like we've got all kinds of runway to get better end markets. And we're not doing as good as we should be and offer products that everybody is going to want to buy.

Jessica Hansen

So, Rehaut, in addition to product positioning and our current footprint and deepening our market share in our current footprint, we have continued to expand where we operate, and our market count this quarter actually moved from 87 markets up to 90. So, we continue to asses where those good permits and jobs and areas that are in the affordable housing on the ground which honestly is almost every market across the entire U.S. So, we will look to continue to expand our footprint as well.

Mike Murray

And then, you did mention kind of the East and the Midwest. With our acquisitions a year ago in the Midwest, we're working with those teams and they're growing their platforms. There is opportunity for that to be a stronger contributor for growth for us going forward. And then, we've talked about the Northeast, and we continue to day by day improve our operations there, and our teams are working hard. And we think that's going to be an increasing driver of our continued growth as well.

Michael Rehaut

I guess, secondly, as you think about order growth or closings growth next year, this year, you kind of moved from sales pace being maybe flattish or slightly up to flat, and then this quarter excluding acquisitions you had more of a high single-digit type of growth, and that's consistent with a lot of the builders that have seen an improved market as well as an easier comp. As you get into next year, how should we expect the balance of community count and sales pace to influence the overall unit volume growth?

Jessica Hansen

After we cycle through this next quarter, really that's when we acquired the three companies we did and really what has been putting our community count growth in that high single digit range. So, without those acquisitions, we've been trending in that pretty low single digit range, only 1% or 2% on a year-over-year basis. And I think, we really just kind of anticipate more of the same in fiscal '20. So community count is slightly up, and it can be a little choppy along the way.

Mike Murray

But, we are seeing as with our refocus on affordability and ensuring that we're driving that everywhere that we can, we're seeing improved absorption for community. And so with our guide of mid to high single digit growth on a community count of low single digit, we're assuming further improvement in per community sales price.

Operator

Our next question comes from the line of Megan McGrath with Buckingham Research Group. Please proceed with your question.

Megan McGrath

I guess, I wanted to ask, if you think about this fiscal year 2019, we went through a lot of movements in interest rates, up and down and ticking back up a little bit. But, I guess looking back, could you tell us that anything surprised you in terms of the reaction of your buyer group to those rate moves which have been debated for a while, what would happen? And if rates continue to pick up, is there anything you would do differently or just your strategy as we move forward?

Mike Murray

Megan, we saw the buyers -- every time that affordability is constrained, the buyers have to readjust and there is certainly a pause in the marketplace. And interest rates are big driver of affordability. At the same time that as Jessica mentioned earlier, that gave us the real focus to get back into our product and think about what we are offering and try to bring housing prices down for our customers at a way that provides -- still provided a good margin for the Company, and we did that. And we'll continue to adjust to the marketplace for whatever the interest rate environment gives us. I do think one of the things that we are seeing is that there's continued job growth in the economy and there's some continued wage growth. And that's very helpful for households. And that large population, that large demographic is aging one year further down, and they're having life events that often drive them to prefer single family housing as their housing choice. And we're well-positioned to provide them with a home for that.

Megan McGrath

Great, thanks. And then, just a follow-up on gross margin, and you talked about flattish from the fourth quarter. Could you maybe walk us through how you're thinking about the headwinds and tailwinds of the big components of gross margin as we look into next year, generally, labor materials and pricing?

Jessica Hansen

So, it’s really just more the same Megan. So, what we're saying in that guide is that we don't have the same level to pull back on incentives as we did this year. We will pretty much have cycled through the higher incentives that we had to institute last year at this time to drive a sales pace. So, we continue to have some limited cost pressures on the labor front that’s consistently been somewhat of a headwind. But, we've worked to offset it in other categories. And generally, now that we've offset, cycled the higher lumber costs, our material costs are net neutral. Our purchasing team’s doing a great job of when we do have a category that the cost is going up, they find a category where we can look to offset it. So, I think our base case would be just to be able to keep those costs in line with whatever type of pricing power or lack of pricing power we might have.

As a reminder though, the really the fiscal 2020 gross margin is going to be dependent on the strength of the spring selling season. And so, this is where we sit today. We feel good about maintaining our gross margin, around the range it is right now. But, it's really going to be dependent on the spring.

Bill Wheat

As you know, we're focused first and foremost on returns. And so, we're going to balance margin, pricing, incentives and pays to generate the best return for community. Right now, we see a good market in front of us. And so, that would indicate we should be able to maintain margins.

Operator

Thank you. Our next question comes from the line of Jack Micenko with SIG. Please proceed with your question.

Jack Micenko

Hi. Good morning. Bill, I wanted to revisit the cash flow comment, I think from maybe the first leadoff question on the call. $1.4 billion this year, north of a $1 billion next year, the October issue, very nice refi of the February 2020 coming due. Is there anything around the cash flow guide contemplating the December 2020? I know, that's a 2%, that's a pretty attractive yield it's going to be probably hard to beat that. But, is any of that in the guide for cash flow for next year?

Bill Wheat

No. That would be beyond our fiscal year. So, we're kind of looking at that as a fiscal 2021 event. So, naturally, with the 2.5% five-year notes we issued in October that does essentially provide the funds to refi and payoff the maturity that we have in the spring, the $500 million we have in the spring. So, that gives us flexibility in our liquidity as we go into the year to invest further or be able to be opportunistic as we need to.

Jack Micenko

Okay, great. And then, on DHI Communities, can you maybe help us size what those gains – obviously, it's a market transaction deal, so not looking for ZIP code, but maybe area code around maybe gains, timing. And then 2b of the question, thoughts on single family rental. There are some going that way and among your peers, someone have said it's not really for us. Just curious as you're growing the rental business overall, where your current thinking is on the single family side? Thanks.

Bill Wheat

So, DHI Communities, we mentioned, we do expect to sell another two projects in fiscal 2020. One of which is under contract to sell as of September 30th. So, we would expect the first project to close in our first fiscal quarter, and then, we expect one more over the course of the year. Little hard to comment on individual transactions around the size of potential gains until they close. But, our projects are ranging in size from high 200 units up to up to 350 to 400 units in general. And so, they are in a fairly tight range in terms of size. So, I would expect significant variations versus the ones we saw this past year.

And then, in terms of single family rental?

Mike Murray

We're continuing to look at that business, Jack. We think it's -- we have an opportunity to provide some value in that space, and we're looking for the best way we can do that right now.

Operator

Thank you. Our next question comes from the line of Mark Weintraub with Seaport Global. Please proceed with your question.

Mark Weintraub

I certainly understand with the strong backlog you've got good visibility on next six months, whatever margin et cetera. I guess, I was a little surprised that when talking about labor and materials, you wouldn't potentially be anticipating more pressure as we get to later into next year, given the order growth that we've been seeing, and given some of the inventory dynamics, which affected you this year and probably the industry as well, which would suggest there is going to be more stress on the home building complex, and so more stress on labor in particular. Any further thoughts on how you are thinking about that in your ability to be in a position? Because it sounded like it wasn't so much that you'd be raising but you thought that those wouldn't be material impacts to your year ahead.

Bill Wheat

So, part of the confidence we have in our cost outlook is looking lot of a national contracts we have from our scale. Secondarily, at a local level the scale we have certainly supports great labor relationships that we've had over the years and our ability to continue to source adequate labor to build our homes on a timely fashion is very constructive for us. And there is cost pressure because the market is strong. We would also expect that there is a potentially a lower level of incentives that would help us mitigate any of those cost leakages that we had through.

David Auld

I'll just add that we worked very, very hard over the years to drive a process that has allowed us to drive more square footage with the same labor hours. And that gives us a lot of comfort and confidence that when labor does get tied again, which I anticipate it will in the spring that we are going to command the greatest percentage of it.

Mark Weintraub

And maybe just as follow-on, did you think your local market scale access is in even bigger advantage in that type of market than what we've been seen, and how does that play out?

David Auld

Well, absolutely. I think, it's a local market scale. I think it's also our commitment to drive a consistent production at each flag. So, we get the trade base into the communities. Our absorption in our typical community is very, very high. So, we're keeping that. And they are not looking for work while they are waiting on us to start houses. It's just a process. It's something we've been working on for a long, long, long time. And I think, we do have both, a loyal trade base and good markets bad markets. I know they're going to get paid. So, that is a competitive advantage for us.

Operator

Thank you. Our next question comes from the line of Ken Zener with KeyBanc Capital Markets. Please proceed with your question.

Ken Zener

Let's start with intra quarter order closings please. What percent of closings were intra quarter orders closings?

Jessica Hansen

It was right where we typically expected in call it 35%, 36% range. It fluctuates anywhere from 30% to 40%, on average, and with a little bit of seasonality sometimes.

Ken Zener

Right. So, if I do that calculation, first, what I believe was 34% last year, what that shows is your closings were up about 7% of your backlog. That's a nice cadence, but really spiked in the spec homes, year-over-year, if you just look at it at units. I ask that to get an understanding of how the margins for your spec first backlog are trending with a third of your closings being spec in an environment where pricing became firmer. Could you kind of talk about that a little bit?

Mike Murray

We saw spec margins compressed or get closer to backlog margin. So, they came up relative to backlog margins. That difference shrunk in the quarter…

Ken Zener

And what would you attribute that to?

Mike Murray

As what you said, it was a firmer pricing environment, a lower incentive environment in our fiscal fourth quarter than it was say in the fiscal second quarter.

Ken Zener

Now, the guidance you gave for revenue, you talked about feeling good in October. Nice. It seemed though like -- it seems like you guys -- except for the first quarter, you guys have really been kind of following what I would consider normal seasonal trends. And then, Bill, I think, you said you expect pace to actually increase in FY20. Was I mistaken?

Bill Wheat

We do, we’re expecting our community count to be up low single digit, but our overall pace to be up mid to high single digit. Yes.

Ken Zener

Why is that? What gives you that confidence is what I'm asking to expect seasonality to accelerate on a order pace basis?

Bill Wheat

Just in general, we would expect that on an annual basis, as we've seen that as we're refocusing on providing attainable housing for people that we're able to see communities perform at a higher sales per flag per week pace than other communities. I mean, so, it's something that we've consistently seen for the past several years is that as these communities open, we're positioning them with the right inventory to get going out of the gate strong and run at very high absorption rates.

Mike Murray

And I would agree with you, Ken. We're not seeing anything different than normal seasonality though, necessarily. We do expect we can run a little bit tighter on our housing inventory in fiscal '20 than we did in '19. We started strong and as we adjusted our revenue expectations, we've kind of spent a year adjusting to align. But, we thought we're very well aligned going into fiscal 2020.

David Auld

I'll just add, our confidence level is really driven by what we're seeing out in the field. And we talk a lot about our people. We talk a lot about trying to get better year-over-year, quarter-over-quarter, day-over-day really. And I would just say we are getting better. So, even though our absorption per flag has been very high through this whole cycle, we are a better company today than we were a year ago, better positioned and our people got another year's experience.

Ken Zener

Understanding it appears that way for your results. Can you talk about how you're trying to control your user side vis-à-vis vendors and if you're seeing whether it's lumber, appliances or these types of other things, perhaps what you've learned over the last year and any changes that you're implementing for FY20? Thank you very much.

Bill Wheat

I think, we're continuing to do what we have done with a lot of our national supply partners, and they're creating a good relationship for us and for them providing a lot of consistent volume demand and potential halo effect into a given marketplace by bringing their product into the trade base. There are some follow-on benefits and we participate in that and they certainly benefit from it as well.

Operator

Our next question comes from the line of Alex Barron with Housing Research Center. Please proceed with your question.

Alex Barron

I was curious whether you guys feel the growth in the overall industry is going to be pretty much in line with the growth you guys are guiding to.

Bill Wheat

Yes. Alex, I would think, we would continue to expect to take market share, and as we like to say, outperform the market, year in, year out, we expect to do better.

Alex Barron

Okay. So, does that mean you expect your affordable percentage of homes to I guess keep growing?

Jessica Hansen

You may not see it from a pure brand perspective in our business, but what we've been introducing really over the last year or so is more and more entry level type houses in our Horton brand as well. So, the answer is yes, but you may not see our Express percentage of a business, climb from the mid-30s, where it is today.

Alex Barron

Got it. And then, in your financial services segment, you guys got pretty nice leverage this quarter, do you expect that to continue in 2020?

Bill Wheat

Yes. We certainly have seen some improvement in efficiencies, their cost for loan is down, they've increased their capture rate, which provides efficiencies on overhead as well. But, a large part of the expansion margin is due to very favorable market conditions as rates drop for this year. The service release premiums are very healthy and that sort of a market and there is less competition from because there is more refi business out there. So, we wouldn't expect to sustain the same level of level margins, they should come down a bit. But, we're pleased with the continued efficiencies we're building into that business.

David Auld

And I'll just add, our mortgage company did a spectacular job this year, not only driving efficiency through their process but in aligning with our homebuilding operations to make the overall transaction better for our customers.

Alex Barron

Okay. And one last one if I may on the Forestar. As you guys are now incurring interest due to the debt you raised, is that going to be capitalized or is that going to be showing up in expenses in what you guys report?

Bill Wheat

Yes. Forestar, their active inventory is greater than their debt. So, they are capitalizing 100% of their interest into their inventory at Forestar.

Operator

Thank you. Ladies and gentlemen, our final question this morning will come from the line of Mike Dahl with RBC Capital Markets. Please proceed with your question.

Unidentified Analyst

Hi. This is actually Chris on from Mike. Thanks for squeezing me in here. So, my first question is just on M&A. Are you embedding any M&A in your 2020 guidance? And given the recent activity in the space, could you just give us an update how you're thinking about public versus private opportunities?

Bill Wheat

We are not embedding any M&A activity into our growth guidance. With regard to our outlook for M&A, for what's right for Horton, typically, it's been the private builders, the add-on builders that give us new capabilities, new teams in various markets. So, that's where we’ll continue to have our focus right now. But, we are always open and are always evaluating whatever is right -- going to be right for us.

Unidentified Analyst

Got it. Thanks for that. And secondly, are you be able to provide the percentage of communities that raised price this quarter, and any regional color, commentary you can provide on pricing power you saw in 4Q?

Jessica Hansen

So, the communities we've raised price on isn't something we typically disclose. We clearly still don't have broad based pricing power across the board. But, I would say, at this point, we've had an ability to pull back on incentives, which is a different function of price, across most of our footprint at this point, maybe a little bit less so at the higher price points where incentives have remained elevated.

Operator

Thank you. Ladies and gentlemen, this concludes our question-and-answer session. I'll turn the floor back to Mr. Auld for any final comments.

David Auld

Thank you, Melissa. We appreciate everyone's time on the call today and look forward to talking to you again in January to share our first quarter results. And to the D.R. Horton team, congratulations on finishing number one for the 18th consecutive year. You are truly the best of the best in this industry. Mike, Bill, Jessica and I are honored and humbled to represent you on these calls. Thank you.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.