

Transcript of
D.R. Horton, Inc.
D.R. Horton Q3 2025 Earnings Call/Webcast
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Participants

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Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.
Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.
Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

Analysts

Alan Ratner - Zelman & Associates
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Presentation

Operator

Good morning, and welcome to the Third Quarter 2025 Earnings Conference Call for D.R. Horton, Americas Builder. We will open the floor for your questions and comments after the presentation.

I would now like to turn the call over to Jessica Hansen, Senior Vice President of Communications for D.R. Horton.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Thank you, Matthew and good morning. Welcome to our call to discuss our financial results for the third quarter of fiscal 2025. Before we get started, today's call includes 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

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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 factors that could lead to material changes in performance is contained in D.R. Horton'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.

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

Now I will turn the call over to Paul Romanowski, our President and CEO.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Thank you, Jessica, and good morning. I am pleased to also 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.

The D.R. Horton team exceeded our expectations and delivered solid results for the third quarter, highlighted by earnings of \$3.36 per diluted share. Our consolidated pretax income was \$1.4 billion on \$9.2 billion of revenues with a pretax profit margin of 14.7%. Our net sales orders in the third quarter were flat with the prior year quarter and increased 3% sequentially. Our tenured operators continue to respond to market conditions with discipline balancing pace versus price to maximize returns in each of our communities, achieving 23,160 homes closed this quarter with a home sales gross margin of 21.8%, both of which were above our guidance range.

We remain focused on maximizing capital efficiency to generate substantial operating cash flows and deliver compelling returns to our shareholders. Over the past 12 months, we have generated \$2.9 billion of cash from operations and we have returned \$4.6 billion to shareholders through repurchases and dividends. For the trailing 12 months ended June 30, our homebuilding pretax return on inventory was 22.1%, while our consolidated returns on equity and assets were 16.1% and 11.1%.

Our return on assets ranks in the top 15% of all S&P 500 companies for the past three, five and 10-year periods, demonstrating that our disciplined, returns-focused operating model produces sustainable results and positions us well for continued value creation. New home demand continues to be impacted by ongoing affordability constraints and cautious consumer sentiment. Where necessary, we have increased incentives to drive traffic and incremental sales. Our cancellation rate

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remains at the low end of our historical range, indicating that buyers in today's market are able to qualify financially and are committed to their home purchase despite the volatility and uncertainty of the current economic environment.

We expect our sales incentives to remain elevated and increase further during the fourth quarter, the extent to which will depend on the strength of demand, changes in mortgage interest rates and other market conditions. With 54% of our third quarter closings also sold in the same quarter, our sales, incentive levels and gross margin are generally representative of current market conditions. We will continue to tailor our product offerings, utilize sales incentives and adjust the number of homes in inventory based on demand in each of our markets. We are well positioned, offering our customers an attractive value proposition with quality homes at affordable price points, and we have a positive outlook for the housing market over the medium to long-term. Mike?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

Earnings for the third quarter of fiscal 2025 were \$3.36 per diluted share compared to \$4.10 per share in the prior year quarter. Net income for the quarter was \$1 billion on consolidated revenues of \$9.2 billion. Our third quarter home sales revenues were \$8.6 billion on 23,160 homes closed compared to \$9.2 billion on 24,155 homes closed in the prior year quarter. Our average closing price for the quarter was \$369,600, down 1% sequentially and down 3% year-over-year. Bill?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

For the third quarter, our net sales orders of 23,071 homes were flat with the prior year quarter, while order value decreased 3% to \$8.4 billion. Our cancellation rate for the quarter was 17%, up from 16% sequentially and down from 18% in the prior year quarter. Our average number of active selling communities was up 4% sequentially and up 12% year-over-year. The average price of net sales orders in the third quarter was \$365,100, which was down 2% sequentially and down 4% from the prior year quarter. Jessica?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Our gross profit margin on home sales revenues in the third quarter was 21.8%, which was flat sequentially and above our expectations. Although our home sales gross margin was stable from the second to third quarter, our incentive costs have increased on recent sales, so we expect our home sales gross margin to be lower in the fourth quarter compared to the third quarter. Our actual incentive levels and home sales gross margin for the fourth quarter will be dependent on the strength of demand, changes in mortgage interest rates and other market conditions. Bill?

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Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

In the third quarter, our homebuilding SG&A expenses increased 2% from last year, and homebuilding SG&A expense as a percentage of revenues was 7.8%, up 70 basis points from the same quarter in the prior year. Our community count is up 12%, and our market count has increased 4% to 126 markets in 36 states. The investments we have made in our team and platform position us to continue producing strong returns, cash flow and market share gains, while remaining focused on managing our SG&A costs efficiently across our operations. Paul?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

We started 24,700 homes in the June quarter, up 24% sequentially from the second quarter, and we expect our starts in the fourth quarter to be lower than the third quarter. We ended the quarter with 38,400 homes in inventory, of which 25,000 were unsold. 7,300 of our unsold homes at quarter end were completed, down 1,100 homes from March. 800 of our unsold homes have been completed for greater than six months. For homes we closed in the third quarter, our construction cycle times improved several days from the second quarter and approximately two weeks from a year ago. Our improved cycle times position us to turn our housing inventory faster, and we will continue to manage our homes in inventory and starts pace based on market conditions. Mike?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

Our homebuilding lot position at June 30 consisted of approximately 600,000 lots, of which 24% were owned and 76% were controlled through purchase contracts. We are actively managing our investments in lots, land and development based on current market conditions. During the quarter, our homebuilding segment incurred \$16 million of inventory impairments and wrote off \$36 million of option deposits and due diligence costs related to land and lot purchase contracts.

We remain focused on our relationships with land developers across the country to allow us to build more homes on lots developed by others, which enhances our capital efficiency, returns and operational flexibility. Of the homes we closed this quarter, 66% were on a lot developed by either Forestar or a third party, up from 64% in the prior year quarter. Our third quarter homebuilding investments in lots, land and development totaled \$2.2 billion, of which \$1.4 billion was for finished lots, \$610 million was for land development and \$140 million was for land acquisition. Paul?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

In the third quarter, our rental operations generated \$55 million of pretax income on \$381 million of revenues from the sale of 1,065 single-family rental homes and 328 multifamily rental units. Our rental property inventory at June 30 was \$3.1 billion,

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which consisted of \$2.5 billion of multifamily rental properties and \$668 million of single-family rental properties. We remain focused on improving the capital efficiency and returns of our rental operations. Jessica?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Forestar, our majority-owned residential lot development company, reported revenues for the third quarter of \$391 million on 3,605 lots sold with pretax income of \$44 million. Forestar's owned and controlled lot position at June 30 was 102,000 lots. 63% of Forestar's owned lots are under contract with or subject to a right of first offer to D.R. Horton. \$320 million of our finished lots purchased in the third quarter were from Forestar.

Forestar had \$790 million of liquidity at quarter end with a net debt-to-capital ratio of 28.9%. Our strategic relationship with Forestar is a vital component of our returns-focused business model. Forestar's strong, separately capitalized balance sheet, substantial operating platform and lot supply position them well to consistently provide essential finished lots to the homebuilding industry and aggregate significant market share. Mike?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

Financial services pretax income for the third quarter was \$81 million on \$228 million of revenues, resulting in a pretax profit margin of 35.7%. During the third quarter, our mortgage company handled the financing for 81% of our homebuyers. Borrowers originating loans with DHI mortgage this quarter had an average FICO score of 720 and an average loan-to-value ratio of 90%. First-time homebuyers represented 64% of the closings handled by our mortgage company this quarter. Bill?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

Our capital allocation strategy is disciplined and balanced to support an operating platform that produces compelling returns and substantial operating cash flows. We have a strong balance sheet with low leverage and healthy liquidity, which provides us with significant financial flexibility to adapt to changing market conditions and opportunities. During the first nine months of the year, homebuilding cash provided by operations was \$1.7 billion, and consolidated cash provided by operations was \$950 million.

At June 30, we had \$5.5 billion of consolidated liquidity, consisting of \$2.6 billion of cash and \$2.9 billion of available capacity on our credit facilities. In May, we issued \$500 million of homebuilding senior notes due 2030. And in June, we increased the capacity of our homebuilding revolving credit facility to \$2.3 billion. Debt at the end of the quarter totaled \$7.2 billion with \$500 million of homebuilding senior notes maturing in the next 12 months.

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Our consolidated leverage at June 30 was 23.2%, and we plan to maintain our leverage around 20% over the long-term. At June 30, our stockholders' equity was \$24.1 billion, and book value per share was \$80.46, up 7% from a year ago. For the trailing 12 months ended June 30, our return on equity was 16.1% and our return on assets was 11.1%.

During the quarter, we paid cash dividends of \$0.40 per share totaling \$122 million, and our Board has declared a quarterly dividend at the same level to be paid in August. We repurchased 9.7 million shares of common stock during the quarter for \$1.2 billion, and our fiscal year-to-date stock repurchases were \$3.6 billion, which reduced our outstanding share count by 9% from a year ago. Our remaining share repurchase authorization at June 30 was \$4 billion. Jessica?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Looking forward to the fourth quarter, we currently expect to generate consolidated revenues in the range of \$9.1 billion to \$9.6 billion and homes closed by our homebuilding operations to be in the range of 23,500 to 24,000 homes. We expect our home sales gross margin for the fourth quarter to be in the range of 21% to 21.5% and our consolidated pretax profit margin to be in the range of 13.6% to 14.1%.

For the full year of fiscal 2025, we now expect to generate consolidated revenues of approximately \$33.7 billion to \$34.2 billion, and homes closed for our homebuilding operations to be in the range of 85,000 to 85,500 homes. We still forecast an income tax rate for fiscal 2025 of approximately 24%. Based on our fiscal year-to-date share repurchases, strong financial position and expected operating cash flows of greater than \$3 billion, we now plan to repurchase \$4.2 billion to \$4.4 billion of our common stock in fiscal 2025, subject to the amount of cash flow generated and share price changes during the fourth quarter. Paul?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

In closing, our results and position reflect our experienced teams, industry-leading market share, broad geographic footprint and focus on delivering quality homes at affordable price points. All of these are key components of our operating platform that support our ability to generate substantial operating cash flows and return capital to shareholders while continuing to aggregate market share.

We recognize the current volatility and uncertainty in the economy, and we'll continue to adjust to market conditions in a disciplined manner to enhance the long-term value of our company.

Looking ahead, we expect a solid finish to our fiscal year, and we have a positive outlook for the housing market over the medium to long term. Thank you to the entire D.R. Horton family of employees, land developers, trade partners, vendors and real estate agents for your continued efforts and hard work.

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

Operator

Certainly. Everyone at this time, we'll be conducting a question-and-answer session. [Operator Instructions] Your first question is coming from Alan Ratner from Zelman & Associates. Your line is live.

Q: Hey guys, good morning. Congrats on the really strong results in a challenging market, really impressive. First question, I guess, on the incentives first. You guided for an uptick here in the fourth quarter. Just curious if you can kind of talk through how incentives have trended through the quarter and into July? And how much of that increase is based on competitive pressures you're seeing from other builders in terms of trying to match them to maintain a certain sales pace versus you going out and trying to accelerate the level of activity a little bit? And what I'm looking at specifically is your starts pace, which did increase pretty meaningfully sequentially in the fiscal third quarter.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Yes, Alan. I think the incentives throughout the quarter were a bit choppy, and we've responded to the market. And in terms of competition, that kind of flows market-to-market. We look to maintain, and we're able to exceed our guidance on closings, and that really comes from our operators at a community level, managing their incentives to drive that result. That being said, as we work through the end of spring and deep into the summer selling season, our incentives have increased some to maintain our pace, which is going to allow us to maintain our guidance at 85,000 to 85,500 for the year. So feel good about our position so far in the quarter.

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

And while starts increased in the quarter, they were basically aligned. Trailing six months starts and trailing six month sales were almost the same number, kind of bringing those back in alignment.

Q: Got it. Yes. I noticed that. Obviously, it pulled back quite a bit in the first half of the year, so it makes sense. Second question, just on the overall consumer. These aren't big changes, but if I look at some of the disclosures you gave on the mortgage side, it looks like the average FICO score of your buyer is down about 5 points year-over-year. It's the lowest, it's been in quite a while. Combined LTV is ticking higher as well. So just any commentary you can give on the strength of the consumer today and if you are seeing any impact at all from student loan repayments resuming and being reported to the credit agencies? Thank you.

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Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

We're seeing more of our buyers selecting an FHA product, and we've probably been very heavily incentivizing that FHA product, offering at 3.99%, probably our most attractive interest rate on the FHA. So that's led more buyers to select that program. Not seeing a lot of impact at this point on the student loan area.

Q: Great. Thank you very much.

Operator

Thank you. Your next question is coming from John Lovallo from UBS. Your line is live.

Q: Good morning guys. Thanks for taking my questions. So the fourth quarter gross margin outlook of 21% to 21.5% is similar to what you put out there for the third quarter, which you obviously beat by 30 basis points. Curious on that beat, was that just a little bit more volume than you expected? What sort of drove the beat? And then in terms of the fourth quarter guide, is it really just the potential incentive load that could drive that lower? Or are you seeing anything change in terms of stick and brick or land cost, things of that nature?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

Yes, John, in the third quarter, as Paul mentioned, our incentives were a bit choppy during the quarter. So a quarter ago, as we looked into Q3, we were seeing the potential for needing to increase incentives through the quarter. As it turned out, it was a little more balanced and it didn't impact the closings and the margins quite as quickly in the quarter as we anticipated a quarter ago. So some margins were flat. But we still, as we said here today, see a trend of higher incentives. Our recent sales and currently our sales and backlog do reflect the higher cost of incentives. And so the closings that we see into July, August, September, we do expect margins to take that step down that we had previously anticipated would occur in Q3.

Q: Understood. And then, it was good to see the share repurchase authorization or the assumption raise from about \$4 billion to \$4.2 billion to \$4.4 billion. I mean what sort of drove the decision to move that higher?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

It's always a balance between what we see in terms of our cash flow, our liquidity level, our leverage on our balance sheet, and we're in our target range there. And so we've had the room to be able to devote a bit more capital to the share repurchase this year. Obviously, with where our share price has been, we feel like the valuation is

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attractive, and so we're taking advantage of that during this time. And so the step-up in the annual level is really just still within our target range for our balance sheet.

Q: Okay. Make sense. Thank you guys.

Operator

Thank you. Your next question is coming from Stephen Kim from Evercore ISI. Your line is live.

Q: Yes, thanks a lot guys. I just want to say, I mean, I think that gross margin guide is a lot better than many had feared. So we're pretty excited about that. I want to talk about your SG&A to start off with. You had pretty good or strong overhead control. I kind of beat you up about that last quarter a little bit, because it was high. I was wondering, was there anything unusual in the quarter this time? And then from a long-term perspective, is kind of the mid-7s still a kind of a good long-term target for SG&A?

And then finally, on SG&A, I think you had said previously that SG&A is kind of sensitive to ASP, and so with your ASP, your average selling price coming down, should we expect this to put some near-term pressure on your SG&A? Thanks.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Sure, Steve. The beat on SG&A is really a function of closings, higher closings volume. Even though our ASP was down, our closings did exceed our expectations. In terms of where we expect our SG&A to be over the long-term, I do think 7% to 8%, somewhere in that range. We're a ways away from that on an annual basis right now.

To your point, when we have significant price appreciation, say, back in 2022, that does really good things for SG&A leverage. So our SG&A improvement from here on an annual basis is probably going to be pretty gradual, but we would expect to continue to make improvements in that in the future years.

Q: Yes. I appreciate that, Jessica. I do notice that your closings while they were a little better than maybe what you thought you actually performed quite well, given that things on a year-over-year basis were still down in terms of closings. So it certainly seems like you've got a good control on your SG&A.

The second question I had regards your ROE and your cash conversion. I think you had said when we last met that you were targeting cash flow conversion of maybe 100%, which I think some folks have had a little bit of difficulty getting to. And I think we're kind of looking to see what could get your ROE higher than or up to near 20% longer term. Both of those seem to speak to maybe some changes on the balance sheet. And I wanted to talk to you or have you talk a little bit about what your longer-term goals are with respect to your balance sheet, should we be expecting inventory

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or maybe rental or maybe Forestar or something in that realm that you would make changes to that would enable your ROE to sort of get a boost? And then maybe also if you bring some inventory levels down that, that might also lead to stronger cash flow conversion. Maybe if you could just sort of opine a little bit on those two points, ROE going higher potentially and also your cash flow conversion. Thanks.

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

Sure. Thanks, Steve. We are in a position to generate much more consistent cash flow yield and cash flow conversion going forward. Today, we believe with where our platform is set up where our balance sheet is. As I mentioned earlier, we're in our target range for leverage and liquidity. So we don't see major changes on that side of the balance sheet going forward.

We are very focused on inventory efficiency and improving inventory efficiency throughout all aspects of our operations in terms of our land holdings, our ownership of finished lots. And then our homes in inventory and our inventory turns there, we are very focused on continuing to improve those turns. And so with that, we do expect. We are setting expectations for ourselves to improve the efficiency of inventory levels. And so that will be a key component to stabilizing and then improving our returns on assets as well as then our returns on equity and our consistency of cash flow generation.

Back to the beginning, we talked about cash flow yield, cash flow conversion, we do expect this year's cash flow conversion to be near 100%. It may not be quite there on a consolidated basis. I think in our homebuilding operations, we would expect 100%, but consolidated maybe not quite there. As we look into future years, we would expect to be much more consistent than we have been in the past. And the key to maintaining an ROE of closer to that 20% is to have a cash flow yield of north of 10% with strong inventory efficiency.

Q: Great. That's really helpful guys. Thanks very much.

Operator

Thank you. Your next question is coming from Matthew Bouley from Barclays. Your line is live.

Q: Good morning everyone. Thank you for taking the questions. I wanted to ask on the community count. I think you said it was up 4% sequentially and up 12% year-over-year. So curious if at this point, if you can give any kind of directional color or quantification on how 2026 may shape out, just kind of given where you'll be entering the year? And I don't know, are you extending out or phasing out communities? Anything along those lines to kind of manage some of that supply growth. So just kind of early '26 expectations and any changes on kind of how you're managing that pace of new community openings. Thank you.

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Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Matt, you would do expect our community count to moderate some. It's been double digit for a bit now, and we do expect it to drift back down into the mid- to high single digit and then to kind of mid. We have opened a fair amount of markets. We've got another four markets out there. And that community count tends to accelerate when we get out into those communities before they start to produce at a higher level of absorption per community.

We feel really good about our footprint, about the progress we've made in the new markets that we've opened. So not concerned about the level of community count we have. And our operators have done a great job of managing their inventory throughout our communities. And we certainly watch that closely, responding to the absorption they're getting community-by-community. Our total specs and our completed specs have come down as we expected to, and we expect that to continue into the fourth quarter. So I feel good about that. But we do expect to see moderation in community count as we move into '26.

Q: Okay. Got it. Thank you for that. And then secondly, your peer this morning spoke about maybe towards the end of June when rates came down a little bit, it seemed like there might have been a bit of a positive response from buyers, and I'm obviously paraphrasing what they said, but it sounded like then July was a little bit choppy. So just curious kind of what you guys are seeing around sort of the rate volatility and into the holiday and now into the early part of summer, just how are you guys been seeing traffic trends these past few weeks? Thank you.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Really, it has been choppy. And that choppiness can be based on rate or the noise that you see in the news cycle these days. And we have been pretty consistent with the rates we've been offering in the market. And because we have great relationships with our realtor community, they understand what we're offering in the market. I think that we have been able to maintain across our footprint in the communities that have been performing well, have continued to. And so far, we've been on track and pleased with what we've seen into July. The incentives are up as we've spoken to. That's why we guided to a little lower gross margin into the fourth quarter, but so far, it seems to be doing okay as far as driving traffic and the incremental sales we need.

Q: Got it. All right. Thanks Paul. Good luck guys.

Operator

Thank you. Your next question is coming from Sam Reid from Wells Fargo. Your line is live.

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Q: Awesome. Thanks so much. I wanted to touch on your third-party broker relationships really quickly. I believe you're somewhat unique in that you embed third-party broker commissions in gross margin. So just curious if you had any color on broker attach rate and the rate you're paying those brokers this quarter and whether there was any step change in that number? I believe one of your large competitors has been moving deeper into third-party broker relationships. Just curious if you had to respond to that?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

Always have a long-term, very good relationship with the brokerage community, and I think we are still north of 80% with our broker attachment rate to our transactions. And we love it that they bring us a qualified buyer, and they're only paid when the home closes. And so we continue to maintain strong relationships. They have been part of our operating model for a long time, and I envision it will be for a long time.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Our average commission stayed relatively flat. So on our overall closings, it's about 270 basis points of impact, if you wanted to look at apples-to-apples gross margin or SG&A versus other builders that recorded differently.

Q: No, that's very helpful. And then you've alluded a few times so far on the call, the higher sequential incentives in the fourth quarter, and it's definitely a very topical today. Could you just talk to the composition though of those incentives that you're embedding in that fourth quarter gross margin guide?

Earlier in the call, I think you mentioned you're leaning more into FHA. And to that end, kind of would it be reasonable to assume that perhaps some of that lower sequential on gross margin could be a function of more buyers utilizing that 3.99% buy down. And then on that 3.99% rate, we've seen it in several markets across our checks, but just curious the uptake on it? Or do you think it's more of a traffic driver versus something the buyer actually ends up going with? Thanks.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Yes. The 3.99% rate where we have it is largely a traffic driver, and it's community specific. I mean I was in a division last week where they were offering everything from 3.99% to no BFC, no rate incentive, just market because they had solid, strong, consistent demand at the pace they expected in that community. I think our average rate in backlog and/or on closings was just over 5%.

So we really do have a range of incentives out there, including multiple programs, whether that's for a buyer that needs no money down or a special arm, which has taken a little better hold. So our operators have done a great job of managing that rate incentive. But by and large, that is the key incentive that has been driving sales

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for us. And that's the biggest component of the incentives that we're seeing in our mix.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

I think we've talked to the 1 to 1.5 points below market pretty consistently. Last quarter, we're pretty transparent about we're probably closer to the 1.5% on average, which is what the just over 5% Paul mentioned would incorporate.

Q: Very helpful. Thanks so much. I'll pass it on.

Operator

Thank you. Your next question is coming from Eric Bosshard from Cleveland Research. Your line is live.

Q: Good morning. Two things. First of all, I'm just curious from a stick, brick and land, where that is in terms of inflation and where you expect that to go from here?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Yes. So on a year-over-year basis, we saw a nice decline in our stick and brick costs on a per square foot basis, down about 2%. Sequentially, that was down about 1%. And then on the lot cost side, we did see the moderation. It's only been one quarter. So we'll see what happens next quarter, but we've talked about that moderating for some time, and so our lot cost was up a mid-single-digit percentage year-over-year, and it was slightly just ever so slightly down sequentially.

Q: From a lot cost perspective, is there anything that you're doing to influence this? Is there anything different in the market that you're seeing that suggests the path for that forward can be a bit of a flatter curve than we've seen?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

I think some of that is mix, down 1% a quarter. I wouldn't expect that with consistency. We really haven't seen a significant shift in the land market. People have pulled back on purchases and delayed purchases and more from the land market negotiating terms and timing of those terms. There certainly are some opportunities out there, but not to the extent that we would expect given the mix of lots that we have across our whole portfolio, anything that's going to change those lot valuations significantly in the coming quarters.

Q: And then the second question from a product or price point, anything that you're seeing change. It was a quarter where you spoke to things were better than expected. I'm just curious from a product mix perspective if there are areas of incremental outperformance or underperformance?

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Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

I think we continue to see strong adoption of some of the smaller plans we've introduced across our markets, probably not having a meaningful material impact on the overall consolidated results yet, but we're encouraged by how some of the smaller product has been well received in the market and the utility is providing for the buyers.

Q: Okay, thank you.

Operator

Thank you. Your next question is coming from Trevor Allinson from Wolfe Research. Your line is live.

Q: Hi, good morning. Thank you for taking my questions. First one is just on your completed and aged spec count. You've made some really good progress over the last couple of quarters working those down. We're also entering the slower time of the year. Just can you talk about how you feel about your completed inventory levels currently? And is there a target level for each of those numbers you'd like to be at as you exit your fiscal year?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

We feel very good about where we are and the progress that we've made in reducing our -- especially our completed spec count. We do expect that to continue to lower. Given our cycle times and continued improvement in cycle times, we just don't need to carry as many spec homes to generate the closings that we're looking for in the quarter and as we look into '26.

So we would expect that to continue to trend down. Don't have a specific target. We're going to respond to the market and make sure that we are starting homes largely in sync with our sales pace into the fourth quarter as we prep for fiscal '26.

Q: Okay. Makes a lot of sense. And then second question is just your views on resale inventory in the markets you operate in. We've heard a lot of builders talk about resale inventory, not being very competitive for new homes. At the same time, we've seen a pretty notable rise in resale inventory since really the middle of last year coincided with some overall demand weakness. So are you seeing more competition there from resell inventory? If so, could you rank where that stands in terms of headwinds in context of affordability and sentiment issues? Thanks.

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

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In the conversations I have with our sales folks and our models, I'm not hearing resale as being a big push back from us or that we're losing customers to resale inventory. That housing stock is generally quite a bit older than it otherwise would have been because it sat dormant for a while and was not brought to market, plus some of the interest rate incentives are not nearly as compelling that are being offered by the resale owners. And it's still a very attractive position for buyers, especially new homebuyers to come look at new home construction. First-time home buyers look at new home construction.

Q: Thank you for all the color. Good luck moving forward.

Operator

Thank you. Your next question is coming from Rafe Jadrosich from Bank of America. Your line is live.

Q: Hi, good morning. It's Rafe. Thanks for taking my questions. I wanted to ask just when you compare the performance in the larger markets that you operate versus some of the smaller markets, maybe where you have more private competition. Is there a big difference? And what are you seeing from the private smaller homebuilders?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

I would say that throughout this fiscal year, we've seen more consistent performance to budget or to planned absorptions from the markets that are smaller, where we operate mostly against the private builders with maybe a public or two in those markets. And those are the markets that largely we have entered as well over the last several years, and our teams are just starting to build out their teams and catch their stride in their communities and performing at a good level.

I think as you look at the larger markets, there certainly is competition, always has been, which we're happy to play in that space, and operators doing well in those as well. But I think if you look at comparison to plan, we're seeing a little better performance this year in the markets, the secondary markets and markets where we have less public builder competition.

Q: Good. That's interesting. Thank you. And then in terms of the land cost impact, I think the last couple of quarters, there is some lot cost pressure from mix. In this quarter, it was a tailwind. If we were to sort of normalize for that, what are you seeing for sort of underlying lot cost in inflation? And just given some of the softness in the market more recently, like when would that sort of underlying trend when is there an opportunity for that to come lower?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

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I think in the near term, we would expect to continue to see mid-single-digit inflation in our lot cost. I mean it's kind of a flow of inventory that's going through there. So the homes we close over the next 12 months, they're pretty much on lots that are identified costed and largely owned by us today.

Going forward, if we continue to see a little bit of softness or changes in the marketplace and that results in changes in land and development costs, we expect to see relief from that inflation going forward, but that would be several quarters out where that inventory came into production and closings.

Q: Great. Thank you. That's helpful.

Operator

Thank you. Your next question is coming from Michael Rehaut from JPMorgan. Your line is live.

Q: Great. Thanks for taking my questions. Appreciate it. First, I just wanted to circle back and make sure I fully appreciated or understood the trends around incentives during the quarter and how they've progressed year-to-date and how you're thinking about them in the next quarter or two. One of your competitors this morning talked about incentives now up each of the last two quarters 70 to 80 bps on average, sequentially each of the last two quarters. I was wondering if you're seeing any type of similar trend, at least on average? I know obviously, market-by-market, it varies a lot. And if you would expect incentives to continue to rise over the next quarter or two.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Mike, I don't think we've quantified our incentives other than talking about them in a high single-digit percentage range. I mean, obviously, if it's netting against revenue or it's in cost of sales, it all falls out in gross margin, which is why users continue to focus on that forward-looking data point. And we did, as we said, start to incentivize more heavily here over the last couple of weeks to drive what we're trying to achieve for the full fiscal year. And so we do expect at the midpoint a 50 basis point decline in our gross margin from Q3 to Q4.

Q: Okay. No, I appreciate that. And I guess, secondly, anything that maybe is offsetting that rise in incentives that you saw this past quarter going into next quarter? Obviously, this quarter still came in above -- a little bit above your guidance, next quarter down 50 bps is not anything too material relative to perhaps some more bearish concerns out there. So anything on the tailwind side that you can kind of put your finger on that's offset some of those headwinds, be it cost or even tariffs or other areas of the construction cost basket?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

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We have seen slight improvement in our stick and brick cost, and so that is a partial offset. But our commentary really over the last year has been that incentives have been increasing. That's been the main driver for the gross margin decline over the last year. Our operators are striving every day to strike the best balance between hitting pace and maintaining margin in each community to maximize returns. And so they're using all the levers they have with incentives to try to balance that.

And so we have seen the pace of incentive cost increases and the pace of margin decline moderate a bit over the last couple of quarters. And then this quarter, it held still flat sequentially, but the trend is still pointing towards a bit higher incentives. And we don't see significant offsets to that, though we will continue to work on costs on the construction side.

Q: Great. Thanks so much.

Operator

Thank you. Your next question is coming from Mike Dahl from RBC. Your line is live.

Q: Thanks for taking my questions. So if we can stick with the cost side of the equation, I mean, we may or may not be in a position to kind of refine views on tariffs to ease all that fun stuff...

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Mike, did we lose you?

Q: Sorry, can you hear me?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Yes. We cut out after fun stuff.

Q: All right. So all the fun stuff around tariffs and potential labor dynamics. You guys given your position in the market and your breadth, have a good holistic view of things like that. Can you just give us your sense of as we've kind of refined as all the headlines come out? Obviously, this wouldn't impact your fiscal '25, but when you think about cost for construction next year on sticks and bricks and then availability of labor, how are you thinking about things?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Mike, we work on our costs every day. And that has been consistent and certainly is going on today in our divisions. From a labor availability, it's plentiful. We have the labor that we need. Our trades are looking for work, and that's why you've seen sequential and year-over-year reduction in our cycle time because we have the

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support we need to get our homes built. And given those efficiencies, we do expect to continue to see reductions in stick and brick over time. Some of that is from design and efficiency of the product that we're putting in the field. And some of that is just from the efficiency of our operations and from the competitiveness from the labor base that's out there today.

Q: Thanks. And then shifting gears, you had a healthy result in terms of kind of the step-up in rentals, both revenue and profitability. It's still a pretty dynamic market out there. So can you just help us understand some of those moving pieces put together in 3Q, how you're thinking about the next couple of quarters given the backlog that you've got on the rental side?

Bill Wheat - Executive Vice President and Chief Financial Officer, D.R. Horton, Inc.

Yes. We have the backlog of identified properties that are in line to sell. We did see a bit of a step-up there in the revenue there this quarter, a little bit better margin on those. That market is still experiencing a lot of transition in the higher rate environment and cap rates that have changed over the last few years. And so we're working on each one of those projects, working them closer to sale. And that is one element of our margin guide as we look to Q4. We would expect, while revenues may still be in the same ballpark or better than where it was this quarter, we do expect margins on the sales in Q4 to be lower in the rental segment than they were in Q3.

Q: Got it. Okay. Thank you.

Operator

Thank you. Your next question is coming from Alex Rygiel from Texas Capital Securities. Your line is live.

Q: Thank you. Geographically, can you comment on demand trends and highlight the outliers?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

We typically don't go into a whole lot of geographic discussion. It's kind of a roll-up of everything we're doing, and we see some of the same national trends, I would say, you see with others and in the resale markets. There's been a lot of change in the dynamics in the Florida markets. And perhaps most so there. Other markets continue to be consistent performers, where there's been limited inventory and limited development of lots, and housing production continue to see strong demand in those markets.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

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Our supplemental data presentation will include our sales and active selling community detail. Again, I think it gets posted after the call. So you'll see on a sequential basis, there's really no outliers outside of the Northwest sales. We're a little bit lagging. And I think we attribute some of that just to the tech buyer and what's going on with potentially uncertainty of the job market and whatnot in the Pacific Northwest. But Otherwise, we saw a decent increase at least on a sequential unusual seasonal basis in our sales, which was a positive.

Q: And real quick, could you talk a bit about your low cancellation rate, what it's telling you about the economy, consumer confidence and buyer credit quality?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

At the rate that we're seeing, which is kind of below our historical average, is that the buyers that are out there and our FICO score at what 720 even with the transition to FHA rate, I think some of that transition is people taking advantage of the lower rates that we can offer with a rate buydown, but people are having to work to get there. And as we introduce smaller product and continue to try and reduce our ASP to expand into that buyer base, we certainly have to go through the process of working through credit, but our teams do a very good job of that. And our mortgage company does an exceptional job of working with those buyers to get them in a position to close on their own.

Q: Thank you.

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

During the quarter, over 12,000 of our customers were first time homebuyers. And so they have people that have worked very hard to get on the homeownership ladder, and we're very proud of this company that we're able to make that happen for so many families quarter after quarter after quarter.

Q: Thank you.

Operator

Thank you. Your next question is coming from Alex Barron from Housing Research Center. Your line is live.

Q: Yes, good morning. I'm sorry if I missed if you mentioned the build time, but can you repeat that? And is there any particular initiatives to try to lower that, such as more in-house labor or manufacturing trusses or any of that kind of stuff?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

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None of that as far as integrating. For us, we have the labor base that we need and a very strong trade base that's very supportive of us. So we don't feel the need to internalize any of that and take on that additional challenge and risk at this time. We've seen sequential reduction in that cycle time over a couple of days. And then two weeks over last year, we're sitting right where we want to be three months, which is below our historical norms. I would not expect to see a significant decline over the next 12 months, but teams are very focused on maintaining that and gaining advantage where they can on cycle time.

Q: Got it. What about efforts to drive greater affordability such as smaller lot sizes or smaller floor plans, any initiatives on that front?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

I think both of those. Alex, you can look at our average square footage, and it's declined consistently over really the last 24 months. I would expect that to continue some. And the key to affordability in this country is to provide a smaller home site with a smaller home that meets the ability of our buyers to close on our home and meet some monthly payment that fits what they're looking for. We just need a little extra help from local governments to allow us to achieve that really across the U.S., but that's an opportunity that we continue to explore every day.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Our average square footage on homes closed was 1,956, which was down 1% from a year ago, which has been just a very gradual decline, but we're down in the last five years a high-single digit percentage on our average square footage. So we expect that just gradual trend of the average shrinking to continue.

Q: Okay. Great. Good luck for the rest of the year.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Thank you.

Operator

Thank you. Your next question is coming from Jade Rahmani from KBW. Your line is live.

Q: Thank you very much. Can you discuss what you're seeing in the market in terms of home prices across the board? If you could quantify any range of price decline you're seeing and also what you might expect going forward?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

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We focus predominantly on incentives where we can and that's allowed us to maintain a lot of our base pricing across the country. That doesn't mean you won't find places where on select houses, in select communities, we are making actual base price reductions. That's generally much more targeted, though, in terms of on completed, aged inventory.

Q: And are you seeing competitors with your product, primarily new homebuilders, but also in the existing home market cut price?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

I think competitive pressures across the board in any given submarket, we're seeing some competitors cut price or resell cutting price, and our local operators respond to every one of those dynamics on a weekly basis. And we're still seeing sales paces in line with the targeted goals for those communities at the right margins to drive the returns we're looking for. So it's going to be a competitive thing we deal with neighborhood-by-neighborhood and trusting our local operators to meet their market week to week to week.

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

And we do generally see though, by and large, builders are much more rational today. You can look at another competitor's results this morning. And I think most builders today are taking a very balanced approach, as it relates to pace and price and not just slashing prices across the board. So we're happy to see the rational approach that the industry is taking today.

Q: Thanks very much.

Operator

Thank you. Your next question is coming from Jay McCanless from Wedbush. Your line is live.

Q: Hey, good morning all. Thanks for taking my questions. And apologies if I missed this, but did you all happen to comment on the Canadian softwood lumber agreement? What gross margin impact that might have on Horton?

Michael Murray - Executive Vice President and Chief Operating Officer, D.R. Horton, Inc.

No, we haven't commented on it. And it will have some potential impact, but we've not quantified that. I know it is a significant step-up in the tariff rates that I think going to effect next month. But we're buying some percentage of that wood, and there's some substitutionary product that would be available as well based upon where that pricing ultimately settles.

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Q: Okay. And then the second question, and I'm sure you guys addressed this earlier, but to hold the gross margin like you all did have the speed, I think that's very impressive, especially given some of the incentives that your competitors are putting out there, I guess. Is there anything from a geographic or a product standpoint that you haven't called out already in this call that you might want to address just to give people a sense of how you might be able to hold that gross margin into the fourth quarter?

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

No. I think, Jay, that the performance this quarter is a credit to our teams out in the field, managing week-to-week, their flow on buyers and sales and traffic that they need to achieve their goals for the quarter. And we were able to outperform, which honestly was a surprise to us relative to our guidance. But we do expect to see a step down in margins as to our guide of 50 basis points as you look into this quarter. We'll be happy to be pleasantly surprised if that occurs again this quarter, but it's very early in the quarter to be able to tell where that's going to land. 54% of the homes that we closed this quarter were sold in the quarter. So we still got a long way to go in this quarter to see how the margin plays out by quarter end.

Q: Great. And then the last one I had. Did you all give any color about fiscal '26 community growth or how you expect that to trend?

Jessica Hansen - Senior Vice President, Communications, D.R. Horton, Inc.

Yes. Paul mentioned that it should ultimately moderate. It's been a low double-digit percentage on an annual basis or -- excuse me, on a year-over-year basis for a while. And we would expect that to moderate to the high-single digit, and ultimately, probably more like a mid-single digit community count growth going forward.

Q: Okay. Great. That's all I had. Thank you.

Operator

Thank you. That concludes our Q&A session. I will now hand the conference back to Paul Romanowski for closing remarks. Please go ahead.

Paul Romanowski - President and Chief Executive Officer, D.R. Horton, Inc.

Thank you, Matthew. We appreciate everyone's time on the call today and look forward to speaking with you again to share our fourth quarter results on Tuesday, October 28th. Congratulations to the entire D.R. Horton family on producing a solid third quarter. We are honored to represent you on this call and greatly appreciate all that you do.

Operator

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Thank you. Everyone, this concludes today's event. You may disconnect at this time, and have a wonderful day. Thank you for your participation.

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