

PulteGroup Inc. (PHM)

\$43.85 (As of 01/23/20)

Price Target (6-12 Months): **\$46.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/23/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: C

Summary

Shares of PulteGroup have outperformed its industry in the past three months. The trend is expected to continue, courtesy of impressive third-quarter results. Higher demand owing to favorable housing dynamics backed by lower interest rates and improved affordability had a positive impact on PulteGroup's performance in the quarter. Third quarter orders grew 13% year over year, attributed to improved demand environment. Precisely, the company's focus on entry-level/first move-up buyers is commendable, considering the ongoing market dynamics. PulteGroup witnessed a 39% jump in orders from first-time buyers. However, rising land, labor and material costs are partly compressing margins. Also, higher SG&A expenses pose a threat. Estimates for 2020 earnings shifted downward over the past 60 days, depicting concern over the stock.

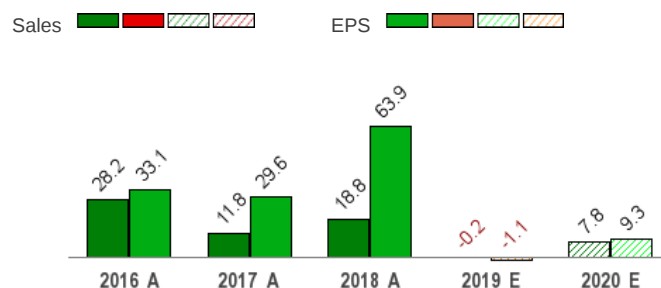
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$44.28 - \$25.10
20 Day Average Volume (sh)	2,630,060
Market Cap	\$11.9 B
YTD Price Change	13.0%
Beta	0.60
Dividend / Div Yld	\$0.48 / 1.1%
Industry	Building Products - Home Builders
Zacks Industry Rank	Top 26% (66 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.8%
Last Sales Surprise	4.1%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/28/2020
Earnings ESP	0.0%
P/E TTM	12.3
P/E F1	11.3
PEG F1	1.7
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,177 E	2,640 E	2,888 E	3,175 E	10,955 E
2019	1,997 A	2,489 A	2,710 A	2,971 E	10,167 E
2018	1,970 A	2,570 A	2,649 A	2,999 A	10,188 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.64 E	\$0.92 E	\$1.03 E	\$1.16 E	\$3.88 E
2019	\$0.59 A	\$0.86 A	\$1.01 A	\$1.08 E	\$3.55 E
2018	\$0.59 A	\$0.89 A	\$1.01 A	\$1.11 A	\$3.59 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/23/2020. The reports text is as of 01/24/2020.

Overview

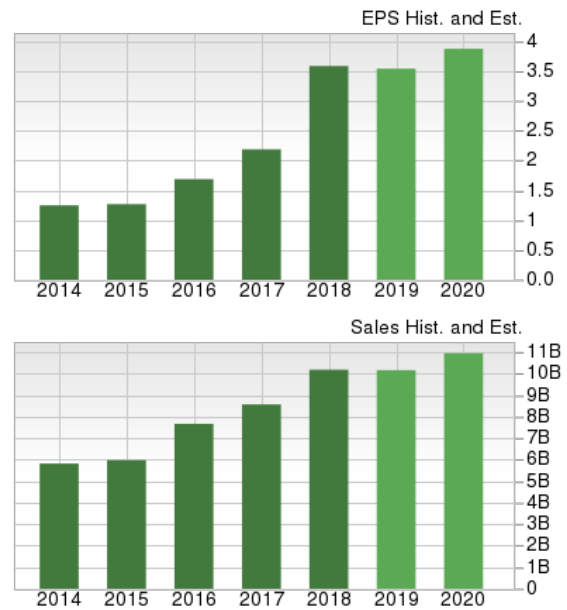
Based in Atlanta, GA, **PulteGroup Inc.** engages in homebuilding and financial services businesses, primarily in the United States. The company conducts operations through two primary business segments – Homebuilding (which accounted for 98% of total revenues in 2018) and Financial Services (2%).

The **Homebuilding** segment offers a wide variety of home designs including single family detached, townhouses, condominiums and duplexes at different prices, with a variety of options and amenities to all major customer segments: first-time, move-up and active adult. Pulte's brand portfolio includes Pulte move-up brand, Centex first-time brand, Del Webb active adult, DiVosta Homes and John Wieland Homes and Neighborhoods.

The company operates in approximately 40 markets across the U.S. The homebuilding division is broken down into six reportable segments; Northeast, Southeast, Florida, Texas, Midwest and West.

Pulte's direct subsidiaries under the homebuilding segment include Pulte Diversified Companies Inc., Del Webb Corporation and Centex Corporation.

Pulte's **Financial Services** business includes mortgage banking and title operations through Pulte Mortgage and other subsidiaries. Pulte Mortgage arranges financing by originating mortgage loans for homebuyers.



Reasons To Buy:

▲ **Land Acquisition & Strategic Initiatives:** PulteGroup's annual land acquisition strategies have resulted in improved volumes, revenues and profitability for quite some time now. In 2018, the company spent \$1.2 billion on land acquisition (13% higher than the 2017 level), as planned earlier. PulteGroup expects land acquisition spend to be approximately \$1.2 billion in 2019. The company spent \$305 million, \$473 million and \$693 million on land acquisitions in the first, second and third quarters of 2019, respectively.

The company expects to realize higher returns on invested capital, given plans to moderate the rate of land spend, increase the use of land options where possible and accelerate inventory turns. PulteGroup's land strategy now emphasizes on investing on shorter-lived smaller land assets while expanding the use of land option agreements when possible, thereby mitigating market risk. Consistent with its efforts to improve overall asset efficiency and reduce land risks by optioning lots, the company has successfully reduced owned land. It ended third-quarter 2019 with approximately 161,000 lots under control, of which nearly 42% were controlled via option. The figure is expected to reach 50% in the near term. It continues to make steady progress toward the long-term goal of owning three years of land or less.

In May 2019, PulteGroup acquired Southern Nevada regional power operator American West, the number four builder in Las Vegas' Clark County. The purchase will enable PulteGroup to leap-frog from the No. 9 position in the Vegas market to very close to No. 1, competing with Lennar for top local honors. With this transaction, PulteGroup acquired approximately 3,600 lots under control, of which nearly 1,200 finished lots were acquired in 11 communities and the remaining 2,400 are to be controlled via options. The land is concentrated in the southwest and southern Las Vegas Valley.

PulteGroup is also maximizing the value of its land assets by selling houses at higher prices and better margins, thereby using the resulting strong cash flow to invest in the business, pay off debt and systematically return to shareholders.

▲ **Focus on First-Time/Entry-Level Buyers:** PulteGroup remains focused on growing demand for entry-level homes, addressing the need for lower-priced homes, given affordability concerns prevailing in the U.S. housing market. The company has been reaping benefits from the successful execution of strategic initiatives to boost profitability, with focus on entry-level homes. In view of these strategic efforts, the growing share of first-time buyers is encouraging. First-time buyers represented 31% of orders and 29% of closings in third-quarter 2019 compared with 25% of orders and 26% of closings a year ago. Also, 13% year-over-year increase in third-quarter order growth was attributed to a 39% surge in first-time buyer orders.

▲ **Active Management of Cash Flows:** PulteGroup has been actively managing cash flows, returning much of its free cash to investors through share repurchases and dividends. During third-quarter 2019, the company returned \$166 million to its shareholders through share repurchases and dividends, after investing \$700 million in the business. This brings the total return to its shareholders to \$340 million in the first nine months of 2019. The company ended the third quarter with \$769 million of cash and a debt-to-total capital ratio of 27.6%, which is down from 35.1% at the end of second-quarter 2019.

▲ **Rebounding Housing Market Fundamentals Bode Well:** The U.S. housing market started building up strength since the beginning of 2019, after a tough second-half 2018. Declining mortgage rates and moderate home prices have been adding strength to PulteGroup and other homebuilders. The overall homebuilding industry remains positive owing to ongoing traffic trends that indicate higher inclination of buyers, thereby reflecting a slow but steady housing recovery. Notably, declining interest/mortgage rates, lower construction costs, low unemployment and increasing wages are somewhat offsetting the other ongoing headwinds. Moreover, as more and more millennials are leaving their parents' home, a sharp spike in household formation is likely to translate into higher demand for new homes.

Notably, PulteGroup's third-quarter orders increased 13% from the last year, with growth across all buyer groups and reporting segments. Moreover, this 13% increase in quarterly orders is the largest percentage increase recorded by PulteGroup since 2017-end.

Prudent land investments, focus on entry-level buyers, returning more free cash flow to its shareholders, along with continued strength in economy and jobs raise hopes

Reasons To Sell:

▼ **Rising Labor, Land and Material Costs:** Rising land and labor costs are threatening margins as they limit homebuilders' pricing power. Labor shortages are leading to higher wages while land prices are inflating due to limited availability. More inflation is anticipated, going ahead. This is denting homebuilders' margins. Also, rising construction material prices have been putting up hurdles for homebuilders.

Rising labor, land and material costs are causes of concern.

PulteGroup's adjusted gross margin in third-quarter 2019 was down 60 basis points (bps) from the prior-year period, as profitability was impacted by higher land, labor and material costs and slight changes in product mix.

It expects homebuilding gross margin for fourth-quarter 2019 in the range of 23.2-23.4% (indicating a decline from 23.8% in the year-ago period), given housing market dynamics and elevated incentive level to drive sales.

▼ **Higher SG&A Expenses:** PulteGroup has been experiencing higher SG&A expenses due to increase in IT spend, operating costs associated with the American West transaction, increased model home costs and compensation. Homebuilding SG&A expenses — as a percentage of home sale revenues — were 10.3% in third-quarter 2019, up 50 bps from the prior-year period. The company also expects SG&A in the range of 10.8-11.3% of home sale revenues, suggesting an increase from 10.3% reported in 2018.

▼ **Federal Government Actions:** The housing industry is cyclical and affected by consumer confidence levels, prevailing economic conditions and interest rates. The federal government's actions related to economic stimulus, taxation and borrowing limits could affect consumer confidence and spending levels, which in turn could hurt both the economy and housing market.

Although strong economy along with labor market strength provide the basis for strong demand, its influence on the homebuilding industry is undeniable and uncertain. Indeed, rising interest and mortgage rates as well as land and labor shortages raise concerns, as do rising material prices. High mortgage rates dilute the demand for new homes as mortgage loans become expensive. This lower purchasing power of the buyers hurts volumes, revenues and profits of homebuilders.

Last Earnings Report

PulteGroup Q3 Earnings & Revenues Beat Estimates

PulteGroup reported third-quarter 2019 results, wherein earnings and revenues surpassed the respective Zacks Consensus Estimate. Higher demand owing to favorable housing dynamics backed by lower interest rates and improved affordability had a positive impact on PulteGroup's performance in the quarter.

The company remains confident about upbeat housing demand for the remainder of 2019, given expectations for lower interest rates and improvement in macroeconomic backdrop.

Quarter Ending **09/2019**

Report Date	Oct 22, 2019
Sales Surprise	4.08%
EPS Surprise	9.78%
Quarterly EPS	1.01
Annual EPS (TTM)	3.57

Inside the Headlines

Earnings per share came in at \$1.01, beating the consensus mark of 92 cents by 9.8%. The bottom line, however, was flat year over year.

Total revenues of \$2.71 billion outpaced the consensus mark of \$2.6 billion by 4.1% and increased 2.3% from the year-ago figure of \$2.65 billion.

Segment Discussion

PulteGroup primarily operates through two business segments — Homebuilding and Financial Services.

Revenues from the Homebuilding segment were up 1.8% year over year to \$2.65 billion.

Moreover, home sale revenues of \$2.64 billion improved 2.5% year over year, given higher deliveries. However, land sale revenues dropped 66.5% to \$8.5 million from \$25.5 million a year ago.

The number of homes closed increased 3% year over year to 6,186. Notably, home closings grew across most of the operating regions served (barring Southeast and Midwest). ASP of homes delivered was \$426,000, down 0.2% year over year.

Importantly, the company's backlog — which represents orders yet to be closed — was 11,638, up 4.2% year over year. In addition, potential housing revenues from backlog increased 2% from the prior-year quarter to \$5.01 billion.

Moreover, new home orders increased 12.7% year over year to 6,031 units in the quarter. Home orders were up across all operating regions served. Value of new orders also grew 11.4% from a year ago to \$2.54 billion.

Margins

Adjusted home sales gross margin was down 60 bps year over year to 23.4% in the quarter. Furthermore, operating margin contracted 140 bps to 12.8%.

Homebuilding SG&A expenses — as a percentage of home sale revenues — were 10.3%, up 50 bps from the prior-year quarter.

Revenues from the Financial Services segment improved 25.6% year over year to \$64.8 million. The segment generated pre-tax income of \$32 million, up 64% from a year ago. Mortgage capture rate in the quarter was 84%, reflecting an increase from 75% in the year-ago period.

Financials

As of Sep 30, 2019, cash and cash equivalents were \$737 million, down from \$1.11 billion at the end of 2018.

In the reported quarter, PulteGroup repurchased 4.1 million shares for \$136 million.

Q4 Guidance

Deliveries are expected within 6,600-6,800 homes versus 6,709 in the year-ago period. ASP is projected between \$425,000 and \$430,000 versus \$430,000 registered a year ago.

Homebuilding gross margin for the quarter is guided in the range of 23.2-23.4% (compared with 23.8% in the year-ago period).

2019 Guidance

Home closing or deliveries are expected within 23,000 — 23,200 (versus 22,300-22,800 homes expected earlier) compared with 23,107 in the year-ago period.

SG&A expense for the full year is expected to be 10.8-11.3% of home sale revenues.

Valuation

PulteGroup shares are up 62.7% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sectors are up 49.8% and 34% in the past year, respectively.

The S&P 500 Index was up 23.9% in the past year.

The stock is currently trading at 11.26X forward 12-month price to earnings, which compares to 11.33X for the Zacks sub-industry, 16.23X for the Zacks sector and 19.13X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.62X and as low as 5.48X, with a 5-year median of 10.05X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$46 price target reflects 11.82X forward 12-month earnings.

The table below shows summary valuation data for PHM

Valuation Multiples - PHM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	11.26	11.33	16.23	19.13
	5-Year High	16.62	15.08	18.83	19.34
	5-Year Low	5.48	7.3	10.63	15.17
	5-Year Median	10.05	10.89	16.23	17.44
P/S F12M	Current	1.08	1.05	1.94	3.56
	5-Year High	1.34	1.23	2.23	3.56
	5-Year Low	0.56	0.65	1.25	2.54
	5-Year Median	0.86	0.92	1.63	3
P/B TTM	Current	2.29	1.52	3.94	4.54
	5-Year High	2.49	2.27	7.22	4.55
	5-Year Low	1.13	1.01	2.19	2.85
	5-Year Median	1.61	1.56	3.41	3.61

As of 01/23/2020

Industry Analysis Zacks Industry Rank: Top 26% (66 out of 255)



Top Peers

KB Home (KBH)	Outperform
Beazer Homes USA, Inc. (BZH)	Neutral
D.R. Horton, Inc. (DHI)	Neutral
Lennar Corporation (LEN)	Neutral
Meritage Homes Corporation (MTH)	Neutral
NVR, Inc. (NVR)	Neutral
Taylor Morrison Home Corporation (TMHC)	Neutral
Toll Brothers Inc. (TOL)	Neutral

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	PHM Neutral	X Industry	S&P 500	DHI Neutral	LEN Neutral	TOL Neutral
VGM Score	A	-	-	A	B	B
Market Cap	11.88 B	2.75 B	24.46 B	21.76 B	21.37 B	6.42 B
# of Analysts	7	3	13	18	8	7
Dividend Yield	1.09%	0.00%	1.75%	1.19%	0.74%	0.95%
Value Score	A	-	-	B	B	A
Cash/Price	0.07	0.10	0.04	0.13	0.04	0.21
EV/EBITDA	9.92	10.54	14.11	10.22	12.71	10.54
PEG Ratio	1.68	1.06	2.04	1.06	1.06	1.31
Price/Book (P/B)	2.29	1.37	3.40	2.12	1.38	1.27
Price/Cash Flow (P/CF)	11.23	9.94	13.66	12.82	10.68	9.82
P/E (F1)	11.38	11.13	19.10	12.08	10.96	11.80
Price/Sales (P/S)	1.17	0.75	2.67	1.24	0.96	0.89
Earnings Yield	8.85%	9.00%	5.23%	8.27%	9.13%	8.47%
Debt/Equity	0.53	0.62	0.72	0.33	0.59	0.77
Cash Flow (\$/share)	3.90	3.60	6.94	4.60	6.30	4.72
Growth Score	B	-	-	A	B	D
Hist. EPS Growth (3-5 yrs)	32.47%	16.06%	10.60%	24.76%	15.42%	25.00%
Proj. EPS Growth (F1/F0)	9.39%	12.95%	7.59%	13.84%	6.93%	-2.69%
Curr. Cash Flow Growth	48.12%	18.07%	13.90%	3.66%	106.81%	-11.99%
Hist. Cash Flow Growth (3-5 yrs)	12.16%	23.21%	9.00%	23.21%	32.93%	13.21%
Current Ratio	0.57	4.04	1.22	7.25	14.19	7.06
Debt/Capital	34.62%	36.98%	42.99%	24.82%	36.98%	43.38%
Net Margin	9.01%	6.29%	11.35%	9.20%	8.31%	8.17%
Return on Equity	20.02%	12.16%	17.10%	16.63%	12.16%	11.83%
Sales/Assets	1.00	0.97	0.55	1.17	0.76	0.69
Proj. Sales Growth (F1/F0)	7.75%	4.83%	4.03%	7.50%	1.74%	0.45%
Momentum Score	C	-	-	C	C	B
Daily Price Chg	2.26%	2.06%	0.26%	2.73%	2.28%	2.43%
1 Week Price Chg	4.50%	3.76%	2.29%	3.61%	5.64%	6.90%
4 Week Price Chg	12.49%	14.19%	2.24%	11.28%	20.08%	16.34%
12 Week Price Chg	11.75%	12.64%	7.79%	12.64%	12.87%	16.39%
52 Week Price Chg	64.23%	45.05%	21.61%	54.02%	49.92%	30.69%
20 Day Average Volume	2,630,060	221,684	1,536,379	3,172,450	3,867,757	2,098,977
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	1.81%	0.04%
(F1) EPS Est 12 week change	0.14%	0.24%	-0.23%	6.39%	2.52%	-3.32%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-3.08%	5.30%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	C
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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