

PulteGroup Inc. (PHM)

\$46.84 (As of 01/28/20)

Price Target (6-12 Months): **\$49.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/23/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: A

Summary

Shares of PulteGroup have outperformed its industry in the past year. The trend is expected to continue, courtesy of impressive fourth-quarter results. Earnings and revenues topped analysts' expectations by 5.6% and 1.5%, respectively. On a year-over-year basis, earnings and revenues grew 27% and 0.6%, respectively. Higher demand owing to favorable housing dynamics, backed by lower interest rates and improved affordability, had a positive impact on its performance. Despite an unimpressive start to 2019, it ended the year on a solid note with \$1.2 billion cash, \$1.1 billion operating cash flow and net debt-to-capital ratio of 21.7%. Focus on entry-level buyers is commendable, considering the ongoing market dynamics. Its orders from first-time buyers jumped 57% in the quarter. However, rising land and labor costs partly compressed margins.

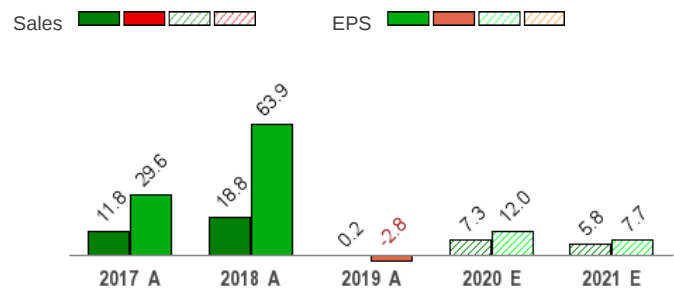
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$47.30 - \$25.10
20 Day Average Volume (sh)	3,283,039
Market Cap	\$12.7 B
YTD Price Change	20.7%
Beta	0.60
Dividend / Div Yld	\$0.48 / 1.0%
Industry	Building Products - Home Builders
Zacks Industry Rank	Top 15% (39 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.6%
Last Sales Surprise	1.5%
EPS F1 Est- 4 week change	0.7%
Expected Report Date	04/28/2020
Earnings ESP	6.2%
P/E TTM	13.0
P/E F1	12.0
PEG F1	1.8
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					11,593 E
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	3,017 A	10,213 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.64 E	\$0.91 E	\$1.07 E	\$1.22 E	\$4.21 E
2020	\$0.65 E	\$0.92 E	\$1.03 E	\$1.16 E	\$3.91 E
2019	\$0.59 A	\$0.86 A	\$1.01 A	\$1.14 A	\$3.49 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 01/28/2020. The reports text is as of 01/29/2020.

Overview

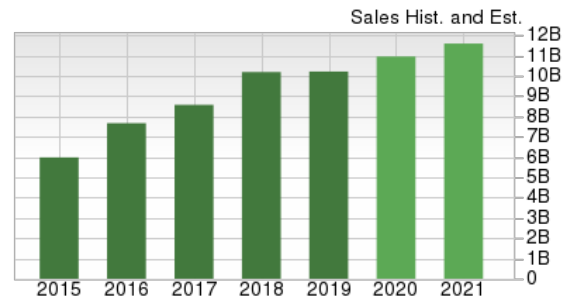
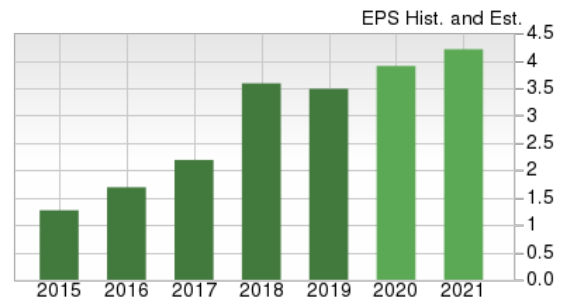
Based in Atlanta, GA, **PulteGroup Inc.** engages in homebuilding and financial services businesses, primarily in the United States. The company conducts operations through two primary business segments – Homebuilding (which accounted for 97.7% of total revenues in 2019) and Financial Services (2.3%).

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 United States. 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 January 2020, the company expanded off-site manufacturing in Florida with the acquisition of Innovative Construction Group, a provider of off-site solutions focused on single-family and multi-family wood framed construction. Off-site solutions are expected to deliver high-quality framing components with less waste that will help it address trade labor shortages, a persistent problem for the construction industry.

In 2019, the company had spent \$3 billion on land acquisition and development. Over the past four years (through 2018), the company has invested more than \$10 billion in land acquisition and development, depicting its clear focus on building a more efficient land pipeline. For 2020, it expects total land spend to increase to \$3.2 billion. Given the existing land pipeline, the company expects 2020 community count growth of 1-3%.

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 2019 with approximately 158,000 lots under control, of which 41% 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.

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 38% of orders and 32% of closings in fourth-quarter 2019 (compared with 26% of closings a year ago). Also, 33% year-over-year increase in fourth-quarter 2019 order growth was attributed to a 57% surge in first-time buyer orders. Consistent with orders, it realized higher absorption rates across its entire portfolio, led by 28% growth in absorptions among first-time buyers.

▲ **Active Management of Cash Flows:** PulteGroup has been actively managing cash flows via returning much of its free cash to investors through share repurchases and dividends. During 2019, the company had returned \$397 million to its shareholders through share repurchases and dividends, after investing \$3 billion in the business. The company ended 2019 with \$1.2 billion cash, \$1.1 billion operating cash flow and net debt-to-capital ratio of 21.7% (down from 28.2% at 2018-end).

▲ **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.

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 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.

Rising labor and land costs are causes of concern.

▼ **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.

▼ **Overvalued Compared to Peers:** The company's stretched valuation is another concern. Its trailing 12-month price to earnings ratio is 13.12, which is higher than the industry's 12.24. This implies that the stock is overvalued than its peers.

Last Earnings Report

PulteGroup Q4 Earnings & Revenues Beat Estimates

PulteGroup Inc. reported fourth-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.

Inside the Headlines

Earnings per share came in at \$1.14, beating the consensus mark of \$1.08 by 5.6%. The bottom line also grew 2.7% year over year. Total revenues of \$3.02 billion outpaced the consensus mark of \$2.97 billion by 1.5% and increased 0.6% from the year-ago figure of \$2.99 billion.

Segment Discussion

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

Revenues from the **Homebuilding** segment were up 0.1% year over year to \$2.95 billion. Moreover, home sale revenues of \$2.93 billion improved 1.4% year over year, given higher deliveries. However, land sale revenues dropped 63.3% to \$21.8 million from \$59.5 million a year ago. The number of homes closed increased 2% year over year to 6,822. Home closings grew across most of the operating regions served (barring Florida, Southeast and Northeast). Average selling price (ASP) of homes delivered was \$429,000, down 1% year over year.

Importantly, the company's backlog — which represents orders yet to be closed — was 10,507, up 20.5% year over year. In addition, potential housing revenues from backlog increased 18.2% from the prior-year quarter to \$4.54 billion. Moreover, new home orders increased 33% year over year to 5,691 units in the quarter. Home orders were up across all operating regions served, given increased community count and higher absorption pace. Value of new orders also grew 35% from a year ago to \$2.5 billion.

Margins

Home sales gross margin was up 130 basis points (bps) year over year to 22.8% in the quarter. On an adjusted basis, the metric was down 100 bps year over year. Furthermore, adjusted operating margin contracted 90 bps to 12.8%. Adjusted homebuilding SG&A expenses — as a percentage of home sale revenues — were 10%, down 10 bps from the prior-year quarter.

Revenues from the **Financial Services** segment improved 26.8% year over year to \$69.8 million. The segment generated pre-tax income of \$34 million, up 580% from a year ago. Mortgage capture rate in the quarter was 84%, reflecting an increase from 77% in the year-ago period.

2019 Highlights

The company reported full-year EPS of \$3.66, reflecting a 3.1% year-over-year increase. Revenues came in at \$10.21 billion, up 0.2% year over year.

Financials

As of Dec 31, 2019, cash and cash equivalents were \$1.22 billion, up from \$1.11 billion at the end of 2018. At 2019-end, its debt-to-capitalization was 33.6%, down from 38.6% at 2018-end. In the reported quarter, PulteGroup repurchased 0.8 million shares for \$30 million. In 2019, it repurchased 8.4 million common shares, or 3% of outstanding shares, for \$274 million.

Q1 Guidance

Deliveries are expected within 5,300-5,500 homes, depicting an increase from 4,635 in the year-ago period. That said, at the midpoint, the guided range represents an increase of 17% over the first quarter of 2019. ASP is projected between \$410,000 and \$415,000, reflecting a decrease from \$421,000 registered a year ago.

Homebuilding gross margin for the quarter is guided in the range of 23-23.3% (compared with 23.4% in the year-ago period). The company expects gross margin to improve sequentially.

2020 Guidance

The company expects double-digit increase in deliveries. Yet, average ASPs will be heading lower due to increased mix of entry level. ASP is expected between \$415,000 and \$420,000 (compared with \$427,000 in 2019). Home closing or deliveries are expected within 25,500 — 26,250 homes, compared with 23,232 in 2019.

Homebuilding gross margin is guided in the range of 23-23.4% (compared with 22.8% in 2019). SG&A expense for the full year is expected to be 10.5-10.9% of home sale revenues.

Quarter Ending **12/2019**

Report Date	Jan 28, 2020
Sales Surprise	1.54%
EPS Surprise	5.56%
Quarterly EPS	1.14
Annual EPS (TTM)	3.60

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 12.02X forward 12-month price to earnings, which compares to 11.53X for the Zacks sub-industry, 16X for the Zacks sector and 18.62X 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 \$49 price target reflects 12.56X 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	12.02	11.53	16	18.62
	5-Year High	16.62	15.08	18.83	19.34
	5-Year Low	5.48	7.3	10.63	15.18
	5-Year Median	10.05	10.89	16	17.45
P/S F12M	Current	1.15	1.08	1.92	3.46
	5-Year High	1.34	1.23	2.23	3.46
	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	2.45	1.55	3.88	4.43
	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	3.62

As of 01/28/2020

Industry Analysis Zacks Industry Rank: Top 15% (39 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	A
Market Cap	12.69 B	2.77 B	23.90 B	22.64 B	21.53 B	6.36 B
# of Analysts	7	3	13	17	8	7
Dividend Yield	1.02%	0.00%	1.8%	1.14%	0.74%	0.96%
Value Score	B	-	-	B	B	A
Cash/Price	0.06	0.09	0.04	0.12	0.04	0.20
EV/EBITDA	10.52	10.47	14.05	10.79	12.23	10.47
PEG Ratio	1.77	1.09	2.00	1.09	1.06	1.29
Price/Book (P/B)	2.33	1.34	3.28	2.16	1.34	1.26
Price/Cash Flow (P/CF)	12.04	9.91	13.57	13.34	11.24	9.73
P/E (F1)	11.98	11.20	18.76	12.45	11.04	11.70
Price/Sales (P/S)	1.24	0.77	2.63	1.25	0.97	0.88
Earnings Yield	8.35%	8.95%	5.33%	8.03%	9.06%	8.55%
Debt/Equity	0.51	0.50	0.72	0.36	0.49	0.77
Cash Flow (\$/share)	3.89	3.64	6.89	4.60	6.03	4.72
Growth Score	B	-	-	A	B	D
Hist. EPS Growth (3-5 yrs)	32.47%	16.06%	10.68%	24.76%	15.42%	25.00%
Proj. EPS Growth (F1/F0)	11.95%	12.95%	7.63%	14.92%	6.93%	-2.69%
Curr. Cash Flow Growth	-2.58%	3.33%	13.04%	3.66%	-6.27%	-11.99%
Hist. Cash Flow Growth (3-5 yrs)	12.16%	23.21%	8.78%	23.21%	32.93%	13.21%
Current Ratio	0.81	4.04	1.24	7.13	14.37	7.06
Debt/Capital	33.63%	32.66%	42.99%	26.48%	32.66%	43.38%
Net Margin	9.95%	6.29%	11.47%	9.74%	8.31%	8.17%
Return on Equity	19.38%	12.00%	17.21%	16.92%	12.00%	11.83%
Sales/Assets	0.99	0.97	0.54	1.16	0.76	0.69
Proj. Sales Growth (F1/F0)	7.27%	4.83%	4.10%	7.95%	1.74%	0.45%
Momentum Score	A	-	-	A	C	A
Daily Price Chg	5.73%	1.19%	0.90%	2.87%	0.73%	1.19%
1 Week Price Chg	4.59%	4.25%	-1.09%	5.03%	5.63%	3.21%
4 Week Price Chg	20.72%	16.04%	0.46%	16.36%	21.49%	16.10%
12 Week Price Chg	22.36%	16.16%	4.15%	21.04%	16.14%	16.16%
52 Week Price Chg	71.89%	42.10%	18.27%	67.34%	47.51%	30.46%
20 Day Average Volume	3,283,039	246,918	1,730,811	3,920,509	3,995,984	2,153,527
(F1) EPS Est 1 week change	0.74%	0.00%	0.00%	0.68%	0.00%	0.00%
(F1) EPS Est 4 week change	0.74%	0.00%	0.00%	0.68%	1.81%	0.04%
(F1) EPS Est 12 week change	0.87%	0.27%	-0.13%	7.12%	2.52%	-3.32%
(Q1) EPS Est Mthly Chg	1.56%	0.00%	0.00%	0.89%	-5.30%	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	B
Growth Score	B
Momentum Score	A
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.

Disclosures

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