Company Description: PHM has broad product offering with a diverse mix of homebuyer type, concepts, geographies and price points. Through its 3 major brands, PHM builds homes for first-time buyers (Centex), move-up buyers (Pulte) and active adults (Del Webb) with move up being the biggest driver of revenue. PHM offers homes in 40 markets across 23 states with none of its 6 geographical segments making up more than 23% of trailing twelve-month deliveries. At the low end, homes are typically offered in the high $200Ks and at the high end they can sell for over $750K. PHM's broad offering across the US has led to the #3 overall market share, in a highly fragmented market.

Name	Ticker	Growth	Dividend	D + G
PulteGroup, Inc.	PHM	11.00%	1.41%	12.41%

Highlights: We emphatically disagree with the prevailing narrative that this year represents “peak earnings” for the homebuilders this cycle, implying a theorized collapse of margins and/or buyer demand due to a combination of cost inflation and rising mortgage rates. In our view, the outlook for further earnings growth remains as strong as ever, underscored by 1) a record-wide supply/demand gap in housing inventory; 2) a dramatically improved U.S. consumer balance sheet; and3) rapidly rising household incomes.

Bull Case:

- ***Cheaper than Dirt*** - PHM is trading at just 4.1x this year’s projected EPS, a 50%+ discount to PHM’s historical median and its lowest P/E since February 2000 along with a book value below 1.0x -- despite a nearly net-debt free balance sheet, accelerating stock repurchases, and a projected 34% ROIC.
- ***A Shift to an Asset Light Model –*** Like other homebuilders, PHM has shifted to a more asset-light model by controlling more land through the use of options, rather than purchasing it outright. In our view, this approach provides PHM with a degree of flexibility (lowers risk in a downturn) and reduces the amount of capital it has allocated toward land inventory at any given time. While optioning carries lower margins, the end result is greater flexibility and balance sheet efficiency. Options as a percent of lots owned and controlled has increased from 31% in FY15 to ~54% in the most recent quarter. Over this time frame PHM has seen a significant increase in inventory turnover and ROE. With this, PHM will be able to focus on return to shareholder via Buybacks and Dividends, as the company’s debt-to-capital ratio is already well below the low-end of their target range.
- ***The Structural Problem A Supply/Demand Imbalance –*** Surge in demand for homes coupled with supply constraints have pressured inventory availability in both new and existing homes. For the undersupplied housing industry, we expect the favorable supply/demand imbalance to persist for the foreseeable future amid ongoing constraints on new home construction while demographic-driven and WFH-driven demand remain resilient. Freddie Mac estimates that the U.S. housing market is 3.8 million homes short of what's needed to meet the country's demand, representing a 52% rise in the nation's housing shortage compared with 2018. The record-low inventory levels of homes have resulted in rent growth and home price appreciation persistently above the rate of inflation throughout the past decade.

Bear Case:

- ***Increasing Mortgage Rates –*** The prospect of rising interest rates, particularly mortgage rates, is likely to create some unease among homebuilding investors, given the real and perceived impact on affordability. Homebuilder stocks historically have maintained an inverse relationship with mortgage rate movements. The potential headwind from rising rates is two-fold: (1) entry level buyers could be priced out of the market, and (2) current homeowners could be hesitant to sell their home that was financed at an attractive fixed mortgage rate and buy a new home that will be financed in a higher rate environment.
- ***Higher Material Costs*** - Material costs, particularly for lumber, drywall and cement, are significant and sometimes volatile components of home construction costs. Lumber (and OSB) costs reached unprecedented levels last year – pricing has been volatile, potentially impacted the company’s margin profile.
- ***Labor Issues -*** Local market share is important to negotiating and building relationships with skilled building trades (includes framers, electricians, and plumbers for example). Builders that are able to provide their subcontractors with consistent flow of jobs tend to get better pricing and efficiency as well as shorter lead times in their build cycles. The labor market in housing construction remains tight and the cost of labor has consistently increased at 3-4% rate annually over the last few years. We expect upward pressure in labor costs to continue (or even accelerate).

Overall Thesis: PulteGroup continues to execute which has resulted in positive EPS estimate revisions, driven by soaring pricing power and record-high profit margins. The upward revisions leave PHM trading at just 4.1x this year’s projected EPS, a 50%+ discount to PHM’s historical median and its lowest P/E since February 2000 -- despite a nearly net-debt free balance sheet, accelerating stock repurchases, and a projected 34% ROIC. Clearly, the market is already bracing for a severe demand shock ahead following an unprecedented 200bp surge in mortgage rates over the past few months. While we anticipate wait lists may thin and price increases moderate, we still see a deep pool of well-qualified buyers amid historic inventory shortages and population migration. Even with a more conservative outlook on 2023 deliveries, margins, and community count, we still see another year of healthy EPS growth ahead, supported by PHM’s willingness to deploy its excess cash flow into highly accretive share repurchases.

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