

## CalAtlantic Group, Inc.

NYSE:CAA

**Analyst:** Alexandre Thiam

**Sector:** Consumer Goods.

**BUY**

Price Target: \$44.90

### Key Statistics as of 11/18/2016

Market Price:	\$33.33
Industry:	Home Builders
Market Cap:	\$3.98b
52-Week Range:	\$26.97-\$43.24
Beta:	1.40

### Catalysts:

- **Short-term:** Potential increase in interest rate would cause people to buy now.
- **Medium-term:** Positive Economic and Real Estate Outlook.
- **Long-Term:** Inflation could involve a housing market recovery.

### Company Description:

CalAtlantic Homes Group was born in 2015 from the merger of two experienced homebuilders called Ryland and Standard Pacific. Both company developed themselves separately since their inception in the 1960's. The merger aimed at "gain both geographic and product diversification, expanding our reach and enhancing our growth prospects in the entry level, move-up and luxury market segments." It is a California based firm that operates in 17 different states from California to New Jersey and as much as 41 major markets. The company not only build houses it also sells properties. It is reported that CalAtlantic is the fourth largest homebuilder in the country. Combining both companies CalAtlantic Group, Inc. built more than 450,000 houses in total. In the 12 months ended June 30, 2015, the pro forma combined company delivered more than 12,786 homes in the aggregate with combined pro forma revenues of \$5.2 billion

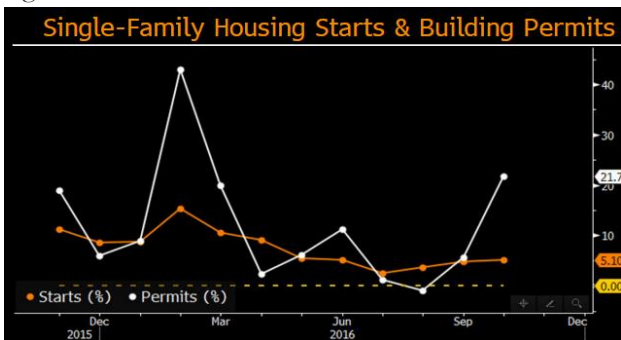


## Thesis

- CalAtlantic is showing signs of undervaluation especially when comparing what the company has to offer with competitors. The company tries to meet customers' expectations and does more than its peers to grow (merger).
- The current financials and relative valuation is showing that CAA is more profitable than most of the industry. The company maintains higher margins in a recovering markets.
- I believe that external macro-economic factor could actually be in favor of the company such as fear in interest hike and future inflation.

## Industry Outlook

CalAtlantic is a home builder and therefore depends heavily on the Real Estate outlook as well as the global economic outlook. Smaller factors such as construction and permits allocations, as well as starts are also driving the industry. Recently, Bloomberg reported that single-family housing starts rose by 22% on a year to year basis to 869,000 homes. It is said to be the fastest pace since 2007, nearly 9 years. The building permits on the other hand increased by 7% YTD which shows good signs for the future.



On a more global view, the economic growth is said to be moderate with low interest rates. Having said that IR could observe an increase in the following month with a potential Fed interest hike. The table below shows the call current rate for short and long maturity mortgage.

	2012	2013	2014	2015	2016	2017	2018
<b>Housing and Interest Rate Forecast, 10/28/2016</b>							
<b>Housing Activity (000)</b>							
Total Housing Starts	784	928	1,001	1,108	1,143	1,258	1,311
Single Family	537	620	647	713	773	873	911
Multifamily	247	308	355	395	369	385	400
New Single Family Sales	368	430	440	502	574	647	677
Existing Single-Family Home Sale	4,125	4,475	4,338	4,627	4,790	4,879	5,000
<b>Interest Rates</b>							
Federal Funds Rate	0.13%	0.13%	0.13%	0.38%	0.44%	1.00%	2.00%
90 day T Bill Rate	0.09%	0.06%	0.03%	0.05%	0.34%	0.87%	1.50%
<b>Treasury Yields:</b>							
One Year Maturity	0.18%	0.13%	0.12%	0.32%	0.63%	1.21%	2.00%
Ten Year Maturity	1.80%	2.35%	2.54%	2.14%	1.74%	2.10%	2.50%
<b>Freddie Mac Commitment Rates:</b>							
Fixed Rate Mortgages	3.66%	3.98%	4.17%	3.85%	3.56%	3.79%	4.00%
ARMs	2.69%	2.88%	3.02%	2.94%	2.79%	3.05%	3.25%
Prime Rate	3.25%	3.25%	3.25%	3.26%	3.53%	4.00%	4.50%

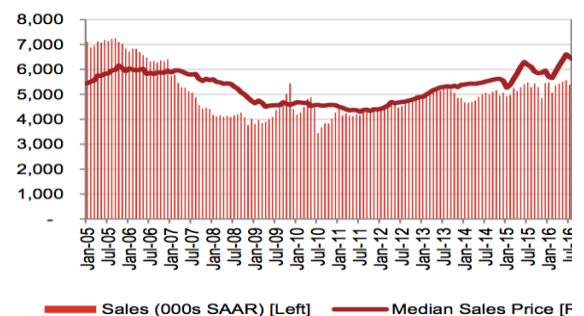
The world economy environment for the past few years is likely to continue in 2016, and will therefore support moderate growth in commercial rents and investment sales.

In 2016, the prime rent are expected to grow at a CAGR of 2.2% for the next 5 years, according to CBRE global rent index. Global real estate investment markets are expected to remain active in 2016, but the pace of growth is expected to slightly decrease after six years of recovery and price appreciation.

Overall, home prices continue to increase in almost every city in the United States. The price have risen at a CAGR of 4.8% for the past two years particularly in the Northwest part of the country. PwC reported that homebuilder could see an increase of demand in the coming month due to a shortage in current level of homes available.

*“The lack of homes available for sale and high prices were enough to offset any boost that low mortgage rate might have provided the market. Affordability remains a problem despite data from the U.S. Census bureau showing strong household income growth. Home prices are still outpacing incomes in many markets because of the shortage of new and existing homes for sale.” - PwC*

## Existing Home Sales

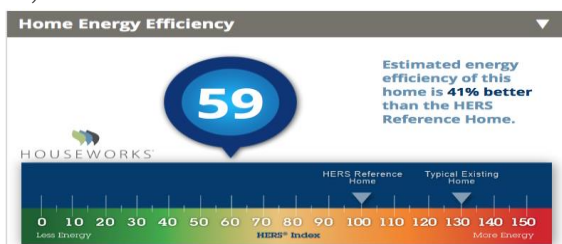


level of comfort than the majority of competition, for and affordable price

## Efficiencies and Cost Savings

In 2015 slightly after the merger, CalAtlantic had to cut about 50 jobs representing the totality of the employees working at Westlake Village home builder (Ryland Group Inc.). In addition to this, the company announced that it will close more office formerly ran by Ryland by the end of 2016, to solely operates from Irvine California based facilities owned by Standard Pacific Corp. When both companies agreed to merge they also both agreed in a 10% cut in workforce. The complete restructuring anticipated annual cost-savings of \$50 to \$70 million. CalAtlantic expect to realize the majority of the estimated savings by late 2016.

One Selling point of CalAtlantic is that they highly focus on energy and other operating efficiencies. A majority of their new homes are tested by independent third parties in order to effectively measure the energy efficiency of each home. On average the company receives a 51 to 60 rating on the HERS index that measure efficiency. The model takes a 100 as basis to do the rating with lower number expressing efficiencies and higher inefficiencies. The current average rating for CalAtlantic shows that on average the new home built by the firm are 40 to 49% more efficient than a standard new home (Base 100, rate 51-60).



Energy Efficiency is part of CalAtlantic's HouseWorks program that is a tool that clients can use to optimize and customize the purchased property. For home interiors the HouseWorks program allows clients to choose from a wide range of appliances and options, among them the "GE Energy Star" appliances which are home appliance that offers considerable savings on energy bills. In addition to the Energy efficiency the houses are equipped with energy saving insulation made out of sand and recycled glass that reduce the need of Air Conditioning or heaters. Houses are also equipped with faucets that use 30 percent less water, and flooring techniques that uses 50% less wood. All in all, these houses offer a higher

## Financials/Relative Valuation

The company is showing promising financials and especially as compared to competitors. As I have mentioned earlier the outlook of the industry looks quite optimistic but the increasing possibility in an Interest Rate hike by the end of 2016 might slightly offset the outlook. Currently the company show signs of undervaluation, with a P/E ratio of 10.48 below the industry average at 12.81. As the merged company is fresh (2015) historical data's are those from Standard Pacific's therefore it might relevant to take a look at the multiples. The FY 2017 forward P/E multiples is at 8.48. The trend is at decrease as the P/E was at 14.07 in 2014. It takes some time for the markets to readjust but I strongly believe that P/E would increase in the coming years. EPS for the firm decrease last year due to the slow demand for the construction of new houses and the increasing prices of new home. The EV/EBITDA multiples are also expected to decreased with a FY 2017 forward at 7.71 as compared to 9.86 trailing twelve-month. The company recently decided to pay dividends of \$0.04 per share and have dividend yields of 0.48% so the forward level that are less than current are not expressing a negative outlook but more a steadier and more stable growth in the future.

Home Energy Efficiency										
Estimated energy efficiency of this home is 41% better than the HERS Reference Home.										
HERS Index										
0 10 20 30 40 50 60 70 80 90 100 110 120 130 140 150										
Less Energy										
More Energy										
Average										
CALATLANTIC GROUP INC										
TAYLOR MORRISON HOME...										
NVR INC										
MERITAGE HOMES CORP										
PULTEGROUP INC										
DR HORTON INC										
MDC HOLDINGS INC										
KB HOME										
HUNANIAN ENTERPRISE...										

On the other hands CAA achieved to maintain good margins as compared to competition. As you can see above, the company has a Gross margin of 22.79% above peer's average at 19.68%, the company actually ranks as a Best-in-class. EBITDA margins are also encouraging for CalAtlantic currently twice the industry with 16.09% compared to 9.10%. Furthermore, Operating margins are higher with 13.79% as compared to 8.81% on average. It doesn't stop year, as a result of the merger Sales Growth YoY are also close to 10% higher than peer's average at 37.58%. All in all, the company as low P/E but keep

on showing encouraging results that go against the current stock price at \$33.33.

## Growth Prospects

As I mentioned above, the company secured strong revenue growth last year with a roughly 45% increase, but the company is also outperforming its peers in other area. For instance, orders are important driver of the well-being of a firm and therefore an indicators for investors. As you can see below, CalAtlantic also recorder more orders for 2016 than the competitors for a total amount of \$1.52 billion.

<span>21 Overview</span> <span>22 Comp Sheets</span> <span>23 Markets</span> <span>24 EPS Preview</span> <span>25 Ownership</span> <span>26 Credit</span> <span>27 Custom</span>											
<span>10 Equity Valuation</span> <span>11 Op Stats</span> <span>14 Profitability</span> <span>19 Balance Sheet</span> <span>20 ESG</span>											
Name (BI Peers)	Sales Growth Yoy (%)	EBITDA Margin (%)	Sales per employee	Orders per employee	Orders (\$)	Avg Orders Price	Backlog (\$)	Backlog Price	Avg Closings	Closings (\$)	
Average	37.58%	9.10%	1.50M	2.25k	1,188	434.58k	3,80k	1,688	474.83k	2,37k	948.42M
001 CALATLANTIC GROUP INC	45.37%	16.09%	1.24M	3.53k	1,528	430.57k	7,31k	3,31B	453.66k	3,68k	1,67B
002 TAYLOR MORRISON HOME...	9.91%	9.34%	1.86M	1.95k	918.62M	471.08k	3,86k	1,87B	485.57k	1,74k	812.19M
003 NVR INC	16.07%	12.55%	1.20M	3.48k	1,378	392.80k	7,66k	2,98B	389.40k	3,92k	1,51B
004 MERITAGE HOMES CORP	18.35%	8.78%	1.84M	1.74k	715.56M	411.95k	3,25k	1,38B	423.21k	1,80k	735.87M
005 PULTEGROUP INC	2.74%	14.23%	1.32M	4.78k	1,838	383.53k	9,42k	3,70B	392.79k	5,04k	1,88B
006 DR HORTON INC	12.32%	11.74%	1.74M	8.74k	2,628	299.77k	11,48k	3,44B	299.61k	12,25k	3,64B
007 MDC HOLDINGS INC	12.66%	5.41%	1.56M	1.30k	570.26M	440.02k	3,45k	1,61B	467.53k	1,29k	575.72M
008 KB HOME	26.28%	5.24%	1.80M	2.51k	929.59M	370.65k	5,23k	1,85B	353.73k	2,49k	910.11M

On other hand the average order price is lower for CAA at \$430k against 434k for the industry showing that the company somehow achieve to sell their property at a lower price than peers. In an environment where prices are increasing it is most likely the best cost provider that will gain market shares over competitors. With that being said, if the demand for new home increase considerably the builders will have more orders and the total amount of available houses would increase causing the prices of housing to go down. With 76,000 owned-and controlled home sites, this single enterprise has strengthen its positions in its homebuilding segments. The plan is to aim at retiring “Baby Boom” adults with discretionary means to buy their lifestyle dream home, and young adult "Millennials," who are gaining traction in their careers after a slow start in the teeth of the Great Recession. A part from the product-line diversity, the merger gives CalAtlantic operational presence, 17 states and gives the firm a top-five status in 15 of those markets.

## Summary

Despite the recent slowdown, housing construction should remain a positive contributor to the U.S. economy. The lack of inventory and the rising prices should normally results in a rise in new construction activity. Therefore home builders are feeling optimistic about the market. The current strong sales and the positive outlook over the next six months seems to be behind the rise in the index. This coincides with the outlook for stronger demand for new home. Having said all that, the like hood of seeing and increase in CalAtlantic is real. To conclude I believe that people would tend to buy and purchase new home now fearing the rising interest in the future.

**CalAtlantic Group, Inc.**  
**(CAA)**

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**BULLISH**

Analysis by Alexandre Thiam

Current Price: **\$33.33**

Intrinsic Value: **\$38.78**

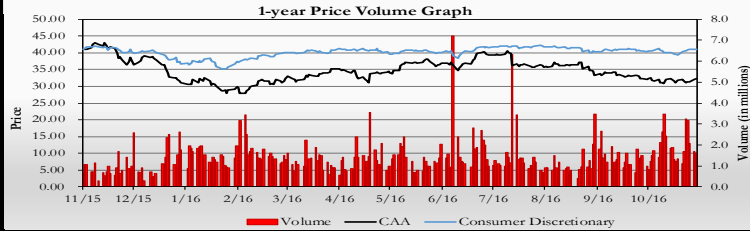
Target 1 year Return: **36.33%**

11/18/2016

Divident Yield: **1.6%**

Target Price: **\$44.90**

Probability of Price Increase: **94.2%**



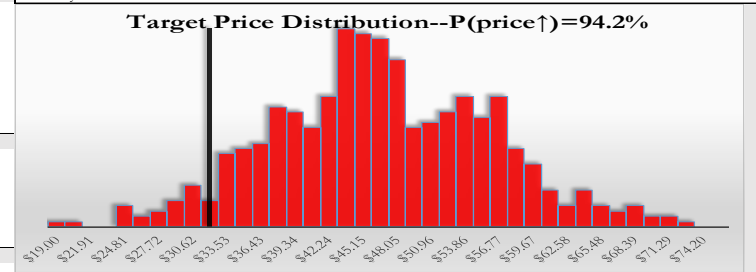
Description  
CalAtlantic Group, Inc. builds single-family attached and detached homes in the United States.

Market Data	
Market Capitalization	\$3,867.49
Daily volume (mil)	1.16
Shares outstanding (mil)	116.04
Diluted shares outstanding (mil)	137.53
% shares held by institutions	74%
% shares held by investments Managers	55%
% shares held by hedge funds	13%
% shares held by insiders	1.29%
Short interest	9.85%
Days to cover short interest	7.85
52 week high	\$43.24
52-week low	\$26.97
Levered Beta	1.57
Volatility	36.47%

General Information	
Sector	Consumer Discretionary
Industry	Household Durables
Last Guidance	November 3, 2015
Next earnings date	February 18, 2017
Estimated Country Risk Premium	6.25%
Effective Tax rate	40%
Effective Operating Tax rate	31%

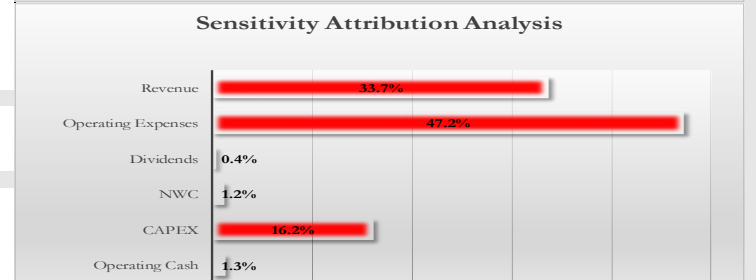
Quarter ending	Revenue	EBITDA
9/30/2015	-23.45%	-34.13%
12/31/2015	-12.36%	30.18%
3/31/2016	-2.58%	-19.57%
6/30/2016	2.04%	-11.61%
9/30/2016	-2.29%	-18.05%
Mean	-7.73%	-10.64%
Standard error	4.6%	10.8%

Peers	
PulteGroup, Inc.	
Lennar Corporation	
KB Home	
NVR, Inc.	
DR Horton Inc.	
Meritage Homes Corporation	
MDC Holdings Inc.	
Toll Brothers Inc.	



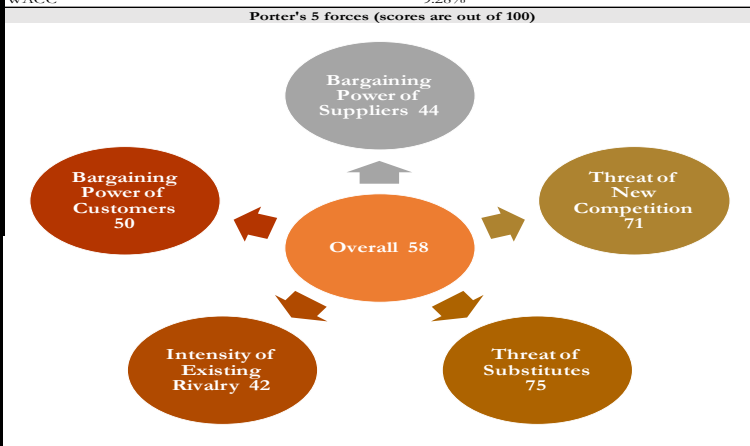
Management	Position	Total compensations growth	Total return to shareholders
Stowell, Scott	Executive Chairman	12.36% per annum over 5y	-2.95% per annum over 5y
Nicholson, Larry	Chief Executive Officer, Pre	N/M	0% per annum over 0y
McCall, Jeffrey	Chief Financial Officer and	-8.33% per annum over 4y	24.56% per annum over 4y
Skelly, Peter	Chief Operating Officer and	N/M	0% per annum over 0y
Babel, John	Chief Legal Officer, Executi	22.3% per annum over 5y	-2.95% per annum over 5y
Marlett, Wendy	Chief Marketing Officer and	2.13% per annum over 5y	-2.95% per annum over 5y

Profitability	CAA (LTM)	CAA (5 years historical average)	Industry (LTM)
ROIC	10.1%	-15.02%	8.36%
NOPAT Margin	10%	-4.96%	7.9%
Revenue/Invested Capital	0.96	3.03	1.05
ROE	20.7%	-37.21%	10.43%
Adjusted net margin	10%	-5.39%	6.8%
Revenue/Adjusted Book Value	1.98	6.91	1.53



Invested Funds	CAA (LTM)	CAA (5 years historical average)	Industry (LTM)
Total Cash/Total Capital	2.2%	4.7%	10%
Estimated Operating Cash/Total Capital	2.2%	3.8%	N/A
Non-cash working Capital/Total Capital	72.0%	73.1%	34%
Invested Capital/Total Capital	85.8%	88.7%	84%

Capital Structure	CAA (LTM)	CAA (5 years historical average)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.92	0.89	0.33
Cost of Existing Debt	5.41%	8.78%	3.58%
Estimated Cost of new Borrowing	4.80%	5.20%	3.58%
CGFS Risk Rating	CC	C	CC
Unlevered Beta (LTM)	1.08	1.32	1.12
WACC	9.28%	11.11%	10.14%



Period	Revenue growth
Base Year	137.9%
9/30/2017	18.4%
9/30/2018	12.9%
9/30/2019	11.9%
9/30/2020	10.9%
9/30/2021	9.9%
9/30/2022	9.0%
9/30/2023	8.0%
9/30/2024	7.0%
9/30/2025	6.0%
9/30/2026	5.0%
Continuing Period	4.1%

Valuation	ROIC/WACC
NOPAT margin	1.09
	0.94
	0.85
	0.92
	0.97
	1.01
	1.04
	1.10
	1.16
	1.22
	1.27
	1.31

Period	Invested Capital	Net Claims	Price per share
Base Year	\$1,633.26	\$3,444.65	\$38.94
9/30/2017	\$2,409.55	\$3,474.04	\$44.57
9/30/2018	\$3,152.36	\$3,496.22	\$50.24
9/30/2019	\$3,816.97	\$3,516.61	\$55.84
9/30/2020	\$6,425.99	\$3,535.61	\$61.26
9/30/2021	\$7,028.44	\$3,485.14	\$66.35
9/30/2022	\$7,633.30	\$2,978.92	\$70.93
9/30/2023	\$8,153.49	\$2,392.67	\$74.54
9/30/2024	\$8,677.82	\$1,753.06	\$76.96
9/30/2025	\$9,187.28	\$1,106.52	\$77.97
9/30/2026	\$9,589.65	\$496.50	\$77.38
Continuing Period			

Period	Revenue growth
Base Year	137.9%
9/30/2017	18.4%
9/30/2018	12.9%
9/30/2019	11.9%
9/30/2020	10.9%
9/30/2021	9.9%
9/30/2022	9.0%
9/30/2023	8.0%
9/30/2024	7.0%
9/30/2025	6.0%
9/30/2026	5.0%
Continuing Period	4.1%