

November 17, 2019

## MDC Holdings: (MDC)

Michael Carman

**Sector:** Consumer Discretionary

**Industry:** Household Durables

**Current Price:** \$38.83

**Target Price:** \$42.00

**Company Description:** MDC Holdings business consists of two primary operations, homebuilding and financial services. Their homebuilding subsidiaries build and sell primarily single-family detached homes that are designed and built to meet local customer preferences. The financial services operations include subsidiaries that provide mortgage financing, place title insurance and homeowner insurance for homebuyers.

## BUY

Current Price: \$38.83  
 Target Price: \$42.00  
 Market Cap: 2.43B  
 Beta: 1.04  
 Daily Volume: 700,000  
 Short Interest: 3.15%  
 Volatility: 27.04%



**Thesis:** I am initiating coverage of MDC Holdings with a buy at \$38 and a target price of \$42. I view MDC as a top home builder in the nation and a benefactor of strong growth in earnings as while achieving a relatively low level of debt. I believe that MDC will benefit for an increase in younger, first-time home buyers due to the fact that they have adjusted their business to focus on more affordable housing. With a positive market outlook, relatively low level of debt and increase in constructed homes, MDC is positioned to make a splash in the coming year.

## Catalysts:

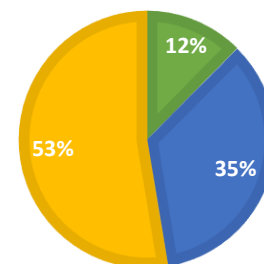
- Increased Focus on Affordable Housing
- Increase in Backlogs
- Increase in acquired lots
- Strong Market Outlook
- Out-Performing Peers
- Strong Capital Structure

## Capital Structure:

MDC currently has a capital structure which does not involve a majority of debt, 53% comes from Stockholder's Equity, 35% comes from the debt and 12% from cash and short-term investments. This allows for MDC to be seen as a less risky investment, they have an equal proportion to both stockholder's equity and debt. With a lower level of debt, this will allow MDC to expand their business acquisitions through debt and not increase their interest expense to an elevated level.

### CAPITAL STRUCTURE

■ Cash/Short Term Investments ■ Debt ■ StockHolder's Equity



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## Section 1: Increased Focus on Affordable Housing

In terms of demand trends by buyers' segment, MDC continue to see relatively better sales activity that are more affordable price communities as compared to their higher price communities. This trend is fairly consistent across their footprint and shows no signs of slowing down. Whether it's a young family buying for the first time, or aging baby boomers looking to downsize, the demand for quality, affordable housing is unlikely to diminish in the near term, as it is getting driven by a demographic factor that should persist for some time. The response to their series of more affordable homes has been tremendous. And they anticipate that their more affordable product will continue to grow as a percentage of their overall business. The dollar value of net orders increased 50% year-over-year to \$871.7 million, driven by a 58% increase in unit net orders that was slightly offset by a 5% decrease in average selling price. The demand for a more affordable product lines remain strong during the third quarter of 2019, accounting for 60% of net new orders compared to 54% a year ago.

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## Section 2: Build to Order Strategy and Increase in Backlogs

As far as their ongoing approach to business, MDC continues to adhere to their build to order strategy, which limits the numbers specs on the ground, and allows them to sell higher margin options of upgrades to their design studios. MDC continues to manage operations with a balanced land supply, carefully weighing risk versus reward before investing in new projects. Gross margin from home sales was up 110 basis points year-over-year to 18.8%. This increase was driven by an \$11.1 million year-over-year reduction in inventory impairments, partially offset by lower margins on spec homes, particularly in our California markets. MDC ended the quarter with an estimated sales value for homes in their backlog of \$2.1 billion, which was up 16% year-over-year on the strength of their new order activity in the third quarter. This backlog value end of the quarter is at highest level since 2006. And is a key factor supporting MDC's expectation for significant year-over-year increases in their revenue and earnings in the coming quarters.

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## Section 3: Increase in Acquired Lots

The number of lots approved this quarter increased by 19% year-over-year following three consecutive quarters of year-over-year declines. This acceleration of activity reflects MDC's confidence in market conditions given the solid sales activity seen so far this year. For the 2019 third quarter, MDC acquired 2178 lots for roughly \$164 million, with an additional \$109 million to spend on development costs. Approximately, 39% of the lots acquired in the third quarter were finished lots. These finished lots allow for MDC to decrease expenses related to construction of new homes and will allow for an increase in the company's operating margin.

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## Section 4: Market Outlook

The market outlook for new home sales for 2020 and beyond is positive, interest and mortgage rates have been on the decline, which allows for more people to purchase homes. Over the next 10 years the population of "first-time homebuyers," a cohort Zillow identifies as having a median age of 34 years old, is expected to be about 3.11 million people larger than it is today according to Zillow. This is good news for MDC Holdings, they have increased their focus on affordable housing options targeted specifically for millennials which should result in increased revenues. In addition, Freddie Mac issued a mostly positive outlook for residential real estate sales activity in 2020. Home sales nationwide are expected to reach 6 million by the end of this year, and then rise to 6.1 million during 2020. In October of this year, Zillow's economists claimed, "United States home values have gone up 4.8% over the past year and Zillow predicts they will rise 2.8% within the next year." All of these factors equivocate for strong growth in sales for MDC and a continued increase in revenue.

## Section 5: Peer and Competitors

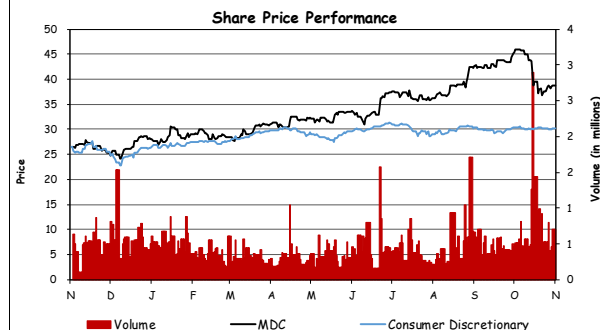
MDC Holdings is currently in a great position for growth in their industry, according to the factor of revenue growth, EPS growth, EBITDA growth, EBITDA Margin, Net Income Growth and Net Debt/EBITDA. In every one of these measurements MDC is either above the industry median or they are the best among their peers. MDC Holdings has experienced the largest revenue growth as well as EPS growth over the last year for a larger company, the only peers that have outpaced MDC are companies such as CCS, which have a smaller market cap, meaning they will grow at a faster rate. In terms of their EBITDA margin, MDC has one of the top EBITDA margins allowing them to generate a higher profit. Lastly, MDC Holdings also has the smallest amount of Net Debt/EBITDA, this makes them less risky in terms of default risk and lower interest expenses. MDC is growing revenues at a faster pace than their competitors with less debt, this in turn will result in faster, stronger growth in the coming quarters.

Company	Mkt Cap	Last Price	Rev Growth 1 Yr	EPS Growth 1 Yr	EBITDA growth	EBITDA Margin	Net Income Growth	Net Debt/EBITDA
MDC	2.43B	38.83	18.92%	49.47%	13.85%	9.29%	6.72%	2.12
MTH	2.7B	70.56	8.88%	43.48%	10.29%	9.14%	7.27%	2.72
TPH	2.14B	15.34	16.10%	36.10%	-28.10%	9.90%	-24.04%	4.44
WLH	783.04M	20.69	16.18%	-2.08%	-26.64%	6.18%	-31.69%	10.92
MHO	1.22B	43.19	16.53%	52.12%	23.15%	8.26%	20.97%	4.12
LGIH	1.63B	71.19	19.59%	35.09%	1.14%	12.27%	4.87%	3.53
CCS	882.43M	28.15	50.82%	92.75%	3.97%	6.49%	7.08%	7.46
KBH	3.03B	34.28	4.09%	-3.97%	12.86%	7.91%	5.90%	4.88

## Conclusion:

In conclusion, I am initiating coverage of MDC Holdings with a buy at \$38 and a target price of \$42. MDC will reap the benefits of a positive new homes market outlook for the coming quarters and next year. MDC has placed an increased emphasis on increasing their production of affordable housing for first time home buyers and has positioned themselves to increase profitability. They are currently outperforming their peers and will soon reap the benefits of aggressive growth in revenue, increase in EBITDA margin and low levels of debt.

M.D.C. Holdings, Inc.	Symbol: MDC
Analyst	Michael Carman
Buy below	\$33.02
Sell above	\$45.76
Probability of Price Increase	100%
Last Price	\$38.83
Intrinsic Value	\$37.73
Target Dividends	\$1.13
Target Price	\$40.15



**Description**  
M.D.C. Holdings, Inc., through its subsidiaries, engages in the homebuilding and financial service businesses.

Sector Consumer Discretionary  
Industry Household Durables  
Last Guidance December 11, 2018  
Next earnings date January 30, 2020

**People**  
Mizel, Larry, Chairman & CEO  
Mandarich, David, President, COO & Director  
Martin, Robert, Senior VP, CFO & Principal Accounting Officer  
Touff, Michael, Senior VP & General Counsel  
Taga, Kelly, Chief Information Officer & VP  
Gard, Karen, Chief Human Resources Officer & VP

**Top Competitors**  
Meritage Homes Corporation LGI Homes, Inc.  
KB Home Century Communities, Inc.  
TRI Pointe Group, Inc. Taylor Morrison Home Corporation  
William Lyon Homes Toll Brothers, Inc.  
M/I Homes, Inc. --

Market Statistics	
Market Capitalization (mil)	\$2,430.75
Last Price per share	\$38.83
52 week high	\$46.84
52-week low	\$23.86
Volatility	27.04%
Daily volume (mil)	0.70
Short interest	3.15%
Days to cover short interest	3.31
Beta	0.58

Financials			
Profitability	MDC (LTM)	MDC Historical	Peers' Median (LTM)
Return on Capital	7.6%		
Adjusted EBITDA Margin	8.6%	7.64%	19.21%
Return on Equity	10.0%		
Adjusted Net margin	4.7%		
Invested Funds	MDC (LTM)	MDC Historical	Peers' Median (LTM)
Cash/Capital			
NWC/Capital			
Operating Assets/Capital			
Goodwill/Capital			
Capital Structure	MDC (LTM)	MDC Historical	Peers' Median (LTM)
Total Debt/(Market Cap.+ Other Claims on Capital)			
Minority Interest/(Market Cap.+ Other Claims on Capital)			
Preferred Equity/(Market Cap.+ Other Claims on Capital)			
CGFS Credit Rating	BB		CC
Credit Rating Model	bbb-		bbb-
Probability of Default Model	bbb to bbb+		b+ to bb-
Likely Current Cost of Debt	0.06%		4.89%
Likely Current Cost of Equity (Cost of Debt + MRP)	5.56%		10.39%
Likely Current WACC	#VALUE!		#VALUE!

Ownership		Change in Ownership (over the past "12" months)
Shares outstanding (mil)	62.60	
Weighted Diluted shares outstanding (mil)	63.16	
Options and Warrants (Shares equivalent)	0.00	
% shares held by institutions	97%	-5.12%
% shares held by investments Managers	69%	-3.33%
% shares held by hedge funds	3.33%	2.66%
% shares held by VC/PE firms	9.220%	0.39%
% shares held by insiders	11.20%	-26.50%
Poison Pill and Type	NONE	

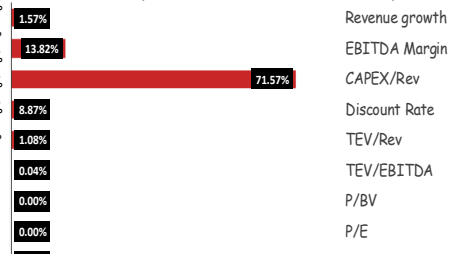
Quarterly Earning Surprises (Actual/Median Estimates)	
Revenue	Last 5 quarters
9/30/2018	\$3142.552 (-0.8%)
12/31/2018	\$3527.5 (6.9%)
3/31/2019	\$2658.728 (11.4%)
6/30/2019	\$3005.764 (2.5%)
9/30/2019	\$3090.648 (0.7%)
<b>History:</b>	<b>Last 10 years</b>
Mean Surprise	3.00%
99th percentile "surprise" range	-8% to 14%
EBITDA	Last 5 quarters
9/30/2018	\$332.588 (-12.4%)
12/31/2018	\$343.036 (-11.9%)
3/31/2019	\$239.576 (-8.1%)
6/30/2019	\$310.96 (-12.3%)
9/30/2019	\$271.576 (-28.2%)
<b>History:</b>	<b>Last 10 years</b>
Mean Surprise	-25.91%
99th percentile "surprise" range	-207% to 155%

M.D.C. Holdings, Inc.	Symbol: MDC	Cost of Capital Estimates			
Analyst	Michael Carman		CGFS Credit Rating	Credit Rating Model	Probability of Default ModelModel
Buy below	\$33.02	Implied Cost of Borrowing (MDC)	4.4%	4.8%	4.4%
Sell above	\$45.76	Implied Cost of Borrowing (Peers)	5.6%	4.9%	5.9%
Probability of Price Increase	100%		Base Year	Explicit Period (15 years)	Continuing Period
Last Price	\$38.83	Cost of New Debt Estimate	4.26%	4.26%	4.26%
Intrinsic Value	\$37.73	Country Risk Premium Estimate	5.50%	5.50%	5.50%
Target Dividends	\$1.13	Cost of Equity Estimate	9.76%	9.76%	9.76%
Target Price	\$40.15	WACC Estimate	7.69%	7.69%	7.69%

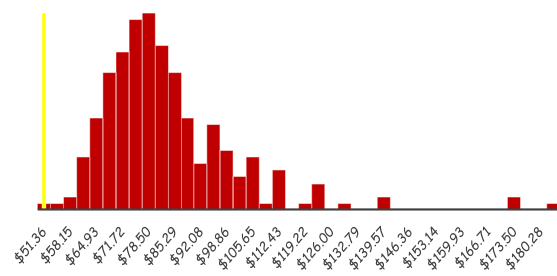
#### Forecast Assumptions

Fiscal Year	Revenue Growth	EBITDA Margin	CAPEX/Revenue	DPR/CAPEX	Other
Base Year (Actual)	17.15%	9.2%	0.9%	0.79	SBC/Revenue 0.77%
year 1	5.75%	12.1%	0.4%	1.67	Constant/same as LTM
year 2	13.63%	13.0%	0.1%	6.63	Lease term 10
year 3	3.42%	12.6%	0.1%	6.22	Rent Expense/Revenue 0.42%
year 4	3.35%	12.2%	0.1%	5.82	Tappers off to historical average
year 5	3.28%	11.8%	0.1%	5.42	R&D life 10
year 6	3.21%	11.4%	0.1%	5.02	R&D Expense/Revenue 0.00%
year 7	3.14%	11.0%	0.2%	4.62	Constant/same as LTM
year 8	3.07%	10.6%	0.2%	4.21	LIFO Reserve Tappers off to zero
year 9	3.00%	10.2%	0.2%	3.81	Non-operating pension costs Tappers off to zero
year 10	2.93%	9.9%	0.2%	3.41	Net financing pensions costs Tappers off to zero
year 11	2.86%	9.5%	0.2%	3.01	Overfunded pension plans Tappers off to zero
year 12	2.79%	9.1%	0.2%	2.61	Capitalized interests Constant/same as LTM
year 13	2.73%	8.7%	0.3%	2.21	Dividends/Revenue 0.00%
year 14	2.66%	8.3%	0.3%	1.80	Tax Rate 24.55%
year 15	2.59%	7.5%	0.3%	1.40	
Continuing Period	2.52%	7.5%	0%	1.00	

#### Simulation Assumptions

Random Variables	Distribution Assumption	MAX	Likely	MIN	
Deviations in annual Revenue Growth--Expl. Per.	Triangular	23.77%	0%	-8.36%	<b>Sensitivity: Price Variance Attribution Analysis</b> 
Deviations in annual Revenue Growth --Cont. Per.	Normal	1.52%	0%	-1.52%	
Deviations from EBITDA Margin base annual estimates	Triangular	3.14%	0%	-0.50%	
Deviations from CAPEX/Revenue base annual estimates	Triangular	0.56%	0%	-0.20%	
Deviations from Kd base annual estimates	Triangular	1.66%	0%	-4.20%	
Deviations from CRP base annual estimates	Triangular	1.82%	0%	-1.92%	
Deviations from TEV/Revenue base estimate	Triangular	0.28	0%	-0.16	
Deviations from TEV/Revenue base estimate	Triangular	13.04	0%	-0.32	
Change in P/BV (TTM)	Triangular	0.95	0%	-0.28	
Change in P/E (FW)	Triangular	1.35	0%	-2.65	
Recovery Rate	Triangular	10.00%	0%	-10%	

#### Valuation

DCF Valuation	Base	Explicit Period (Average)	Continuing Period	<b>Intrinsic Value Distribution--Probability (Upside)=100%</b> 
Revenues	\$3,070.66	\$4,370.33	\$5,556.59	
EBITDA Margin	9%	11%	8%	
UFCF	\$29.44	\$210.70	\$311.01	
WACC	7.69%	7.69%	7.69%	
ROIC	7.64%	9.12%	6.99%	
Relative Valuation	Median Justified Multiple	Basis	Implied Equity Value	
EV/Rev (FW)	0.9x	\$3,314.40	\$2,216.30	
EV/EBITDA (FW)	8.6x	\$405.76	\$2,581.76	
P/BV (TTM)	1.2x	\$1,678.02	\$1,937.09	
P/E (FW)	9.8x	\$227.93	\$2,225.76	

#### Asset Based Valuation

Recovery Rate	60%	Valuation Summary			Intrinsic Value	Target Price	Model Weight
Capital	\$3,795.14	DCF Valuation	\$	44.30	\$	47.43	50%
Intangibles	\$6.01	EV/Rev (FW)	\$	35.09	\$	36.58	25%
Claims	\$1,228.66	EV/EBITDA (FW)	\$	40.88	\$	42.81	25%
Implied Equity Value	\$1,044.82	P/BV (TTM)	\$	30.67	\$	31.82	0%
		P/E (FW)	\$	35.24	\$	36.74	0%
		Asset Based Valuation	\$	16.54	\$	16.60	0%
		Price per Share	\$	41.14	\$	43.56	100%