**MEDIA: Television**

**STATION: BNN**

**MARKET: Canada National**

**DATE: 2023-09-14**

**TIME: 10:57 AM ET**

**PROGRAM: Morning Markets**

**SUBJECT: Joe Ahlersmeyer - Homebuilders**

**PAGE COUNT: 4**

**AMBER KANWAR, BNN:**

Well, homebuilding stocks have been a runaway success so far this year, outperforming the S&P 500. Many are close or at an all time high. Our next guest believes that they can continue to move higher. We've got Joe Ahlersmeyer, who is the Equity Research Analyst for this sector at Deutsche Bank and he joins me now. Joe, thanks so much for joining us. I think when people saw a rising interest rate environment, an inflationary environment, that this was not necessarily going to be conducive to the housing market, and yet these homebuilders just ran away. What were the fundamentals underpinning that?

**JOE AHLERSMEYER, DEUTSCHE BANK:**

Yeah, thanks for having me. I really appreciate that. A lot of the questions that I get at the beginning of the meetings that I'm having are how have the builders continued to do so well despite elevated interest rates, and really it comes down to one thing, and it's fundamental demand that underlies the strength in housing. This is not ‘05-’06 where you had a lot of investor demand coming into the marketplace and bidding up to the house prices. This is fundamental household formation that's driving demand and with respect to the affordability equation, yes, home prices have risen significantly since pre-COVID. You had a tremendous run up in interest rates as well, which has pinched particularly the entry level home buyer, but ultimately there is still sort of this underlying need for those buyers to go out and buy a home and the builders are willing to work with them in terms of buying down interest rates as well. And with respect to the prices of the actual stocks themselves, I hear a lot of talk about all time highs. Well, these stocks are actually driven more on the value of the inventory that they have on the balance sheet because ultimately that is the inventory. Those are the assets that are going to drive the profits in the future. And so if you look at the book value per share of a lot of these home builders, really all of these home builders, since the beginning of the pandemic, that book value has risen quite substantially and so it makes sense that the stocks are at all time highs.

**KANWAR:**

And so your picks today are builders, but then also components that go into housing,

you've got D.R. Horton, Meritage Homes, and TopBuild. D.R. Horton is one of the big players. Am I right that it kind of skews to higher end?

**AHLERSMEYER:**

Actually, they skew more towards the affordable and I don't want to say lower end because that would diminish the product quality, but yes, in fact, it's a great opportunity to talk about what the opportunity is in the market for builders. A lot of people are talking about the existing home market being locked in because people's mortgage rates were refinanced in 2020 and so nobody is moving. There's no existing supply. That is typically where an entry-level buyer is going to start out their home-owning journey: in the existing market with an entry-level starter home. There's just no supply, though, for those buyers, yet the demand remains there. So we like Horton despite the fact that the affordability equation is actually kind of tough for that buyer simply because those are the buyers that are being pushed into the new home market and with respect to the company's ability to execute against that, I mean, they are a machine. This is a production machine. They're not a custom home builder. They're building a highly standardized product that is easy to schedule the trades for, easy to buy materials and so you get a lot of production efficiency that improves the returns and our view is that the valuations are highly dependent on the returns on inventory. So that's why we like Horton here.

**KANWAR:**

Sorry, I was confusing it with Toll Brothers , which is that kind of more on the luxury side. Meritage is a smaller player. Why do you like this one?

**AHLERSMEYER:**

Yeah, absolutely. And you say smaller players. It's smaller within the public builders and it's certainly just a fraction of the size of Horton in terms of the volumes that they produce. But this is still the fifth largest builder in the country and that sort of illustrates the fragmentation as you get down the curve of the competitive landscape. But even just thinking about the markets that they build in, they don't build in every market in the country. They don't even build in most markets in the top 50. In fact, today they announced they're entering Jacksonville, Florida. You would think a nationally skilled builder would be everywhere. But in fact, they're entering a new market and that's what we like about Meritage is in addition to some of the things we talked about with D.R. Horton with respect to production efficiency and potential for higher returns. They also have the ability to outgrow the market because they're going to be expanding beyond their core markets, right? They've already entered four major markets in the last several years. They're also now entering Jacksonville. So book value growth is a big component of the stock value, the stock price growth. We think that that's an important part of the Meritage thesis.

**KANWAR:**

And lastly, BLD, this is sort of a different pick and maybe a roundabout way to get in housing.

**AHLERSMEYER:**

Absolutely. And when you think about a builder, home building in general, it's really a misnomer for what these companies do. They are general contractors. They are subcontracting out really every part of the home construction process, from pouring the foundation to framing, to installing insulation. And that's where BLD comes in. So TopBuild is a distributor installer of insulation. Most of the business, most of the residential business does include their employees going into the builder's job sites and installing that insulation. So for all the reasons that we like home building, and for all the reasons that we're favorable about the outlook for construction, that translates directly to TopBuild. TopBuild and their main competitor, Installed Building Products, they're roughly two thirds of the residential insulation install market. And so it's a highly consolidated market, but the rest of it is actually highly fragmented. So they have the ability to grow with the market. They also have the ability to deploy capital to M&A and continue to roll up smaller players within the industry and grow above market. And then there's also some category specific tailwinds around insulation that relate to energy efficiency, limited capacity for production of the product that is favorable for pricing. So the algorithm for top line and bottom line growth is very strong. And these are also very capital-lite businesses, all they really have is the inventory and balance sheet.

**KANWAR:**

I only have 20 seconds left, not even, but Lennar reports, and you are a sell on that. Why?

**AHLERSMEYER:**

So it goes back to our framework that we initiated in May around returns relative to price tangible book value. The home builders are not a monolith. There's not just the home building industry. Everybody has different exposures, different business models, and different ways that they employ their capital to try to earn a return. We just see greater opportunity for higher returns at Horton and Meritage and others like that. So it really just comes down to simply within that framework, Lennar is less attractive.

**KANWAR:**

All right, thanks so much. That is Joe Ahlersmeyer joining us from Deutsche Bank.