

Analyst Report: Daniel Carpenter, Nikiel Kim, Lee Nero

November 10, 2020



Date: November 18, 2020  
 Company Ticker: MHO  
 Sector: Consumer Discretionary  
 Industry: Household Durables

Forward P/E: 6.52  
 Sector Forward P/E: 9.70  
 Market Price: \$44.54  
 Estimated Fair Price: \$35.83

**Recommendation: Sell**

### Company Summary

M/I Homes is a single-family homebuilder who also offers mortgage-banking services to home buyers and title services. Their homebuilding operations are designing, marketing, and construction, and sales of single-family homes and attached townhomes. M/I Homes operates across three major business segments: Northern Homebuilding, Southern Homebuilding, and Financial Services. The Financial Services segment provides mortgages, title insurance, and closing services through its subsidiary, M/I financial.

### Industry Outlook

Per IBISWorld, revenue for the US homebuilder industry is expected to grow at a yearly rate of 2.6% over the next five years. A short-term burst in activity is likely for homebuilders, as near-zero interest rates will lead to an increase in the construction of homes. However, we believe that a return to moderate interest rate levels in the short-to-mid-term will ease growth in the housing market – resulting in increased inventory levels and a decline in new contracts. Following economic recovery from COVID-19, the industry faces uncertainty in consumer creditworthiness, a continuing increase in the price of raw materials needed for home construction, and an unlikely increase in millennial demand for homeownership. MHO is uniquely exposed to these factors because of its homebuilding operations.

### Earnings Forecast

Account Information Report Date	Forecast					As Reported Historical Data		
	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17
<b>Income Statement</b>								
Revenue	5,212,334	4,521,313	3,921,903	3,401,960	2,950,948	2,500,290	2,286,282	1,961,971
Land & housing expense	4,181,602	3,627,229	3,146,352	2,729,227	2,367,402	2,005,861	1,836,704	1,561,022
Impairment of inventory & investment in unconsolidated joint	5,000	5,000	5,000	5,000	5,000	5,002	5,809	7,681
General & administrative expense	242,320	221,315	201,594	183,213	166,161	147,954	137,779	126,282
Selling expense	321,843	279,175	242,164	210,059	182,210	154,384	142,829	128,327
Acquisition & integration costs	-	-	-	-	-	-	1,700	-
Equity in income of joint venture arrangements	311	311	311	311	311	311	312	539
Interest expense	21,375	20,384	17,382	20,242	21,460	21,375	20,484	18,874
<b>Total costs &amp; expenses</b>	<b>4,772,451</b>	<b>4,153,414</b>	<b>3,612,803</b>	<b>3,148,051</b>	<b>2,742,544</b>	<b>2,334,887</b>	<b>2,145,617</b>	<b>1,842,725</b>
<b>Income (loss) before income taxes</b>	<b>439,883</b>	<b>367,899</b>	<b>309,100</b>	<b>253,909</b>	<b>208,403</b>	<b>165,403</b>	<b>140,665</b>	<b>119,246</b>
Provision (benefit) for income taxes	102,224	85,496	71,832	59,006	48,431	38,438	33,626	48,243
<b>Net income (loss)</b>	<b>337,659</b>	<b>282,403</b>	<b>237,269</b>	<b>194,903</b>	<b>159,972</b>	<b>126,965</b>	<b>107,039</b>	<b>71,003</b>

Our earnings forecast for M/I Homes is based on numerous drivers such as revenue growth year over year, mortgage loans held for sale as a percentage of sales, etc. (see our earnings forecast to review all drivers used). Some of these drivers are basic but some are industry specific. Our earnings forecast uses data from as far back as Q1 2016 and forecasts all the way out to Q3 2021. Almost all line entries are based on the drivers mentioned above, which are based on historical averages and regression analysis.

## Valuation

Free Cash Flow to Equity (FCFE)	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17	Dec-16
Net Income	339,898	280,642	234,008	195,185	161,798	126,965	107,039	71,003	55,329
Add back depreciation	(1,000)	-	7,000	(4,000)	5,850	(6,263)	(3,070)	(11)	790
Subtract increase in current assets	(192,198)	(326,342)	(309,608)	(240,585)	(151,131)	(26,675)	(115,972)	(294,373)	(167,152)
Add back increase in current liabilities	1,300	8,700	13,600	17,400	18,298	7,211	25,625	28,675	80,593
Subtract increase in fixed assets at cost	(1,000)	7,000	3,000	1,850	(26,513)	(2,056)	(5,660)	(3,738)	(10,751)
Net new Debt	50,736	57,685	55,535	51,978	49,842	(67,774)	31,794	229,161	23,721
<b>Free cash flow</b>	<b>197,736</b>	<b>27,685</b>	<b>3,535</b>	<b>21,828</b>	<b>58,144</b>	<b>31,408</b>	<b>39,756</b>	<b>30,717</b>	<b>(17,470)</b>

### Discounted Cash Flows

Cost of Equity	13.81%
Long Term Growth in Free Cash Flow	3.50%
Short Term Growth Rate	15.28%
Sector Forward P/E Ratio	9.7

Report Date	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17	Dec-16
Free cash flow	28,147	197,333	(47,113)	94,216	45,649	(83,592)	39,756	30,717	(17,470)
Terminal Value	282,578								
Total	310,725	197,333	(47,113)	94,216	45,649				

Enterprise value	473,479	<i>Conditional, please trace back</i>
Add Year 0 cash and marketable securities	6,083	
Asset value in year 0	479,562	
Subtract out value of firm's debt today	-	

Most Likely Equity Value	\$ 1,017,041
Year end shares outstanding	28,386
Most Likely Equity Value Per Share	\$ 35.83
11/17/2020 Trading	\$ 44.54 <i>Overvalued by 19.6%</i>

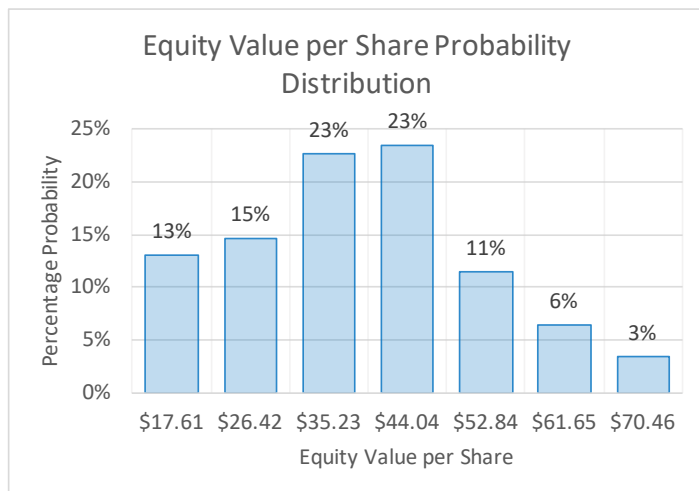
Current Outstanding Recommendation **SELL**

A standard long-term growth rate of 3.50% is used, while the short-term growth rate comes from historical trends (averages) year over year. The short-term growth rate we calculated was 15.28%. The cost of equity we calculated was 13.81%. The Cost of equity is dependent on the long-term growth rate and the firm forward P/E ratio. Additionally, the Q3 Earnings Call revealed that management did not plan to aggressively service existing debt. Although the cost of equity may seem relatively high, we believe these factors and forward P/E ratios among comparable firms justifies this decision. The sector forward P/E ratio was pulled from Yardeni Research's November 11<sup>th</sup>, 2020 report.

## Sensitivity Analysis

While we have an idea of what the most likely equity value, and subsequently, the equity value per share is, we have also sketched out other equity value, and the probabilities of these values. The equity value per share that we believe is the most likely is \$34.02.

Equity Value	Equity Value per Share	Probability
\$ 500,000	\$ 17.61	13%
\$ 750,000	\$ 26.42	15%
\$ 1,000,000	\$ 35.23	23%
\$ 1,250,000	\$ 44.04	23%
\$ 1,500,000	\$ 52.84	11%
\$ 1,750,000	\$ 61.65	6%
\$ 2,000,000	\$ 70.46	3%



## Conclusion

Based on the analysis provided above, we recommend selling our position in M/I Homes. Based on our analysis and calculations, we believe that M/I Homes shares are overvalued by around 23%, with a value of \$34.02.

Enterprise value	1,003,029	<i>Item will vary within spreadsheet due to probability range</i>
Add Year 0 cash and marketable securities	6,083	
Asset value in year 0	1,009,112	
Subtract out value of firm's debt today	-	

Most Likely Equity Value	<b>\$ 1,017,041</b>	
Year end shares outstanding	<b>28,386</b>	
Most Likely Equity Value Per Share	<b>\$ 35.83</b>	
11/17/2020 Trading	<b>\$ 44.54</b>	<i>Overvalued by 19.6%</i>

**Current Outstanding Recommendation** **SELL**