MADISON'S TIMBER PREVIEW

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Recent moves in share prices of the major US home builders may surprise some, but should not be unexpected by *Madison's* regular readers, as they had been informed over one year ago that those large corporations announced they would complete deals to build significant new property developments by September 2013.

Exactly on schedule, this week news broke of Toll Brothers' plan to build 90 new high-end homes on 600 acres in Texas, last month KB Homes held grand openings at several large planned communities in the US and Canada, and last week Tracey Ryniec of Zack's made Hovnanian Enterprises the stock market Bull of the Day.

Toll Brothers' latest project, in the growing northern quadrant of the Houston, TX, is the second largest land contract in the area for the national home builder behind its previous acquisition in Montgomery County in November of 2012. Toll Brothers is also building luxury homes in Dallas, San Antonio, and soon in Austin, TX.

Providing further boosts to company shares, the latest National Association of Home Builders/Wells Fargo Housing Market Index, released Thursday, rose another 3 points to 59 for its highest reading since 2005. As a result, homebuilder stocks soared throughout the day, with Lennar Corp experiencing more than a 1 per cent surge.

Turning their attention back to real estate, analysts see great upside coming for the big US home builders, and are in fact saying share prices at the moment seem somewhat weak given the strength of resurging US home sales and home building.

KB Homes Thursday was trading below the 50 day moving average and lower than the 200 day moving average. Shares of KB Home closed at US$17.21, up $0.86, or 5.26 per cent, in the last trading session. Thursday's volume of 9 million shares is greater than the average volume of 4M shares.

Meanwhile, *Bloomberg BusinessWeek* said also Thursday, that shares of homebuilders rose as an analyst maintained an optimistic view on a recovery in the housing market.

The stocks shrugged off a decline in the broader market, as the S&P 500 slipped 1.4 per cent to 1,662 in afternoon trading. Analyst Jay McCanless said around 836,000 new homes are expected to be started this year, and starts will climb over the next few years as unemployment decreases.

"We anticipate the current housing recovery should peak in 2015 with total housing starts of 1.3 to 1.4 million that year," he said.

McCanless says Ryland Group and Meritage Homes Corp are his top picks in the sector. He rates both stocks at "Buy," and also has that rating on shares of DR Horton and PulteGroup. He rates shares of Beazer Homes, KB Home, and Lennar Corp "Neutral" and has an "Underperform" rating on Toll Brothers shares.
Shares of Ryland Group rose US$1.29, or 3.7 per cent, to US$36.09.

Thursday's data from the NAHB, upbeat though it is, could be wishful thinking, warns Paul Ausick of 24/7 Wall Street.
Sub-indexes that measure current sales conditions and sales expectations came in at 62 in July, its highest level since early 2006. The reading on sales expectations rose one point to 68, and the sub-index that estimates prospective buyer traffic remained unchanged at 45. The reading for sales expectations is the highest since March 2006.

On Tuesday, the NAHB also reported that housing affordability has slipped across the United States. In 2Q 2013, 63.3 per cent of new and existing homes sold were affordable for families earning the median income of US$64,400, down from 73.7 per cent in 1Q, and the first time the index has fallen below 70 per cent since late 2008.

Rising home prices and mortgage loan rates are beginning to take a toll on home sales, says Ausick. Share prices for publicly traded home builders peaked in May, with PulteGroup up nearly 90 per cent, Beazer USA Homes up about 68 per cent, D.R. Horton up about 50 per cent, and Toll Brothers up 21 per cent. The SPDR S&P Homebuilders ETF is up nearly 43 per cent. Since mid-May, all are down between 13 per cent and 40 per cent.

Since May the 30-year fixed mortgage rate is up more than a full point, and even though rates remain at 4.5 per cent or lower, buyers are getting more cautious. In most areas, home prices remain well below their peaks, even though prices are up. Buyers are probably smart enough to know that sub-4 per cent mortgage rates will not return any time soon, so they likely are being more cautious due to uncertainty about the US economy, explains Ausick.

Housing stocks have fallen from their recent highs. Yet builders like Hovnanian Enterprises are still expected to generate double digit earnings growth this year and in 2014, said Tracey Ryniec of Zack August 12.

"Is this stock weakness a buying opportunity," she asked?

Hovnanian reports earnings outside of the normal earnings cycle. It reported 2Q earnings results all the way back on June 5. But it was a sign of things to come with the rest of the homebuilders as it easily beat the Zacks Consensus by 120 per cent.

The company made a penny, beating the Zacks Consensus by 6 cents. The Zacks Consensus was looking for a loss of 5 cents.

Revenue was up 23.8 per cent to US$423 million. For the first six months of fiscal 2013, revenue rose 27.8 per cent to US$781.2 million.

Hovnanian was able to raise home prices in the quarter throughout the country to offset increases in labor or material costs. Homebuilding gross margin percentage increased 150 basis points to 18.9 per cent, from 17.4 per cent in 2Q 2012.

Backlog also rose 23 per cent to 2,827 homes compared to Apr 30, 2012.

Just in case anyone was actually beginning to feel encouraged, RBC analysts Robert Wetenhall and Desi DiPierro Thursday cut their forecast for housing starts to 925,000 in 2013, down from 950,000, and took the knives to their price targets for the sector.

They wrote:

"We are cutting estimates and price targets for homebuilder stocks to reflect concerns about slower order growth and lower valuations. The downward revision to our estimates reflects our view that the pace of the housing recovery will moderate in the absence of faster economic growth and historically cheap mortgage financing. We expect that order growth for the public homebuilders will generally be consistent with the broader housing market which points to an increase of 14 per cent instead of our prior forecast of 26 per cent in 2014, and 10 per cent instead of 17 per cent in 2015. A high degree of seasonality and rising interest rates also means that valuations will most likely remain under pressure with little chance of multiple expansion in the near-term."

Their favorites in the sector include Lennar, KB Home, and PulteGroup.

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