



BY MICHAEL MARKOWSKI

In 2006, I warned in *EQUITIES* of the home-building industry's dangers and singled out Centex (NYSE: CTX) and D.R. Horton (NYSE: DHI) as being especially risky. The shares of both then depreciated over 20%. So why is this industry now a buy?

Until recently, the home-building industry's annualized cash flow from operations had been negative for nine consecutive quarters, beginning in October 2004. Up until the 12 months ending Jan. 31, 2007, it had declining annual cash flow for 10 consecutive quarters, and it had increased its annualized cash flow in only one of its 15 most recent quarters.

Prior to 2007, the last time the industry had two consecutive quarters of annualized cash flow growth was January 2003. During this dismal period, the industry dropped as low as 215 out of 216 industries covered by StockDiagnostics.com for annualized cash flow growth and as recently as the 12 months ending July 31, 2006, the home building industry ranked 209.

Fast-forward to the 12 months ending Jan. 31, 2007, and you'll find a complete reversal of fortune. The industry's annualized cash flow not only turned from negative to positive but also grew by over

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109% compared to the same period in 2006. Within the six-month period between July 2006 and January 2007, the home-building industry's ranking rocketed from 209 to 12 on StockDiagnostics.com. The industry's growth has continued to accelerate for three consecutive quarters, and with a cash flow growth rate of 255% for the 12 months ending July 31, 2007.

The price-to-tangible-book-value (P/TBV) ratio for the home building industry confirms that homebuilders have hit bottom. Tangible book value is more conservative than book value because it excludes soft assets, such as goodwill, from its calculation. The P/TBV of the home-building industry hit a 10-year low of 0.9 in the quarter ending Sept. 30, 2007, meaning that the aggregated value of the industry's shares were trading lower than the value of its net assets; the industry's previous P/BTV low of 1.0 occurred in 2000. It then reached its 10-

year high of 4.0 in 2004.

The home-building industry has established a very predictable cyclical pattern that has occurred twice over the last 10 years. The three components of that pattern are the simultaneous change in annualized cash flow from negative to positive, the

change in the cash-flow growth rate from negative to positive, and a P/TBV at or around the low end of its historical range. Each of these occurred simultaneously in 2000, and within 12 months the P/TBV expanded to 1.8.

Finally, the price-to-cash-flow (P/CF) ratio also confirms a bottom for the home-building industry, as it also hit a 10-year low of 0.9 in the quarter ending Sept. 30, 2007, meaning that the aggregated value of the industry's shares were trading at a lower price than the annualized cash flow those shares were generating. The industry's five- and 10-year high P/CFs were 3.7 and 9.0, respectively. The bottom line is that the industry has bottomed out, and the shares of many of its companies are now a buy for the first time since 2000. The home-building industry will significantly outperform the market for the next 12 months.

The table consists of 11 home-building public companies that most recently

had positive cash flow, positive cash-flow growth, and were trading below their tangible book values. Two particularly

interesting companies are Dominion Homes (NASDAQ: DHOM) and Standard Pacific (NYSE: SPF). Both are trad-

ing at less than tangible book value per share and at less than their annualized cash flow. **E**

Homebuilders with Positive Cash Flow & Share Price Under Book Value Per Share

Symbol	Company	Current Share Price	Bk Val per share	P/TBV	P/CF	Annual Pos. CF % chg.	Market cap
BZH	BEAZER HOMES USA	9.93	38.56	0.26	1.81	227.32	389.3M
DHOM	DOMINION HOMES	1.99	15.53	0.13	0.63	1,579.98	16.9M
SPF	STANDARD PACIFIC	5.24	22.99	0.23	0.87	211.77	340.2M
MHO	M/I HOMES	17.04	41.45	0.41	2.5	184.78	239.5M
PHM	PULTE HOMES	15.36	21.74	0.71	4.93	214.24	3.93B
LEN	LENNAR	25.31	33.81	0.75	5.29	197.54	3.20B
RYL	RYLAND GROUP	25.63	32.94	0.78	4.68	253.97	1.07B
CTX	CENTEX	29.33	37.64	0.78	3.19	323.64	3.54B
DHI	D R HORTON	14.37	17.58	0.82	3.19	189.68	4.52B
KBH	KB HOME	29.90	33.74	0.89	1.55	465.68	2.67B
MDC	M D C HLDGS	42.27	43.01	0.98	2.87	419.59	1.93B

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