



D. R. HORTON INC.

HOLD

Daily Closing Price



Stock Data

Price (52 weeks)	\$16.03-\$36.36
Symbol/Exchange	DHI
Beta	1.091
Dividend yield	.28
Fully diluted shares	157.20M
Average daily volume	1354363
Current market cap	\$5.79B
Book Value/Share	\$18.24

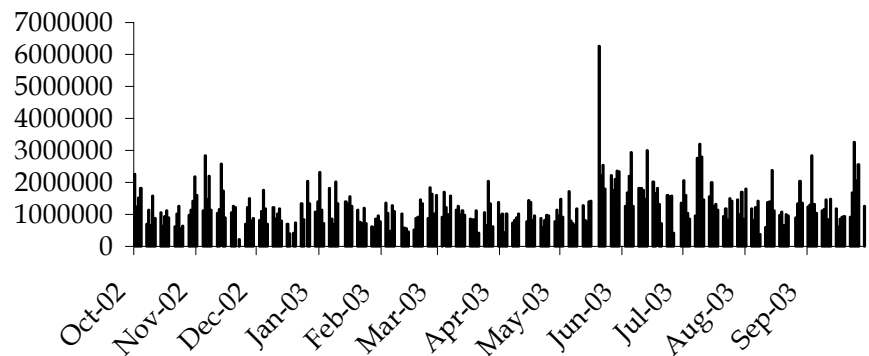
Valuation (per share)

FCF Analysis	\$25.05
Comparables Analysis	\$32.31
Current Price	\$36.35

Summary Financials (in millions)

Revenue	\$6.74B
EBITDA	\$908.62M
Free Cash Flow	\$95.71M

Daily Volume



Business Overview

The D. R. Horton Construction Company was incorporated on July 1, 1991 in Delaware, after acquiring all the assets and businesses of 25 predecessor companies, all of which were previously owned or controlled by D. R. Horton. Since they were incorporated, D. R. Horton has acquired 17 other home building companies to help differentiate their product offering. D. R. Horton Inc. is now one of the largest nationally recognized homebuilders engaged primarily in the construction and sale of single family housing in the metropolitan areas of the mid-Atlantic, the midwest, the southeast, the southwest and the western regions of the United States. Their financial reporting segments consist of home building activity and financial services.

	Year Ended September 30,		
	2000	2001	2002
	(In millions)		
Mid-Atlantic	\$ 614.5	\$ 615.6	\$ 639.5
Midwest	451.0	457.6	493.8
Southeast	491.5	518.2	634.2
Southwest	1,176.7	1,489.5	2,003.9
West	870.5	1,302.7	2,853.8
Total	\$3,604.2	\$4,383.6	\$6,625.2

Homebuilding services

As of September 30th, 2002, D. R. Horton has operating divisions in 20 states and 44 markets . The markets the Company operates in include Albuquerque, Atlanta, Austin, Birmingham, Charleston, Charlotte, Chicago, Colorado Springs, Columbia, Dallas, Denver, Fort Collins, Fort Myers/Naples, Fort Worth, Greensboro, Greenville, Hawaii, Hilton Head, Houston, Inland Empire (Southern California), Jacksonville, Killeen, Las Vegas, Los Angeles, Maryland-D.C., Miami/West Palm Beach, Minneapolis/St. Paul, Myrtle Beach, New

Jersey, Oakland, Orange County, Orlando, Phoenix, Portland, Raleigh/Durham, Sacramento, Salt Lake City, San Antonio, San Diego, San Francisco, Seattle/Tacoma, Tucson, Ventura County and Virginia-D.C.

<u>Years Entered</u>	<u>Markets</u>
1987	Phoenix
1988	Atlanta, Orlando
1989	Charlotte
1990	Houston
1991	Maryland-D.C., Virginia-D.C.
1992	Chicago, Raleigh/Durham
1993	Austin, Los Angeles, Salt Lake City, San Diego
1994	Minneapolis/St. Paul, Las Vegas, San Antonio
1995	Birmingham, Denver, Greensboro, Miami/West Palm Beach
1996	Albuquerque
1997	Greenville, New Jersey, Tucson
1998	Charleston, Hilton Head, Jacksonville, Killeen, Myrtle Beach, Portland, Sacramento
1999	Columbia
2000	Ventura County
2001	Fort Myers/Naples
2002	Colorado Springs, Fort Collins, Hawaii, Inland Empire (Southern California), Oakland, Orange County, San Francisco, Seattle/Tacoma

D.R. Horton continually monitors the sales and margins achieved in these markets as part of their ongoing evaluation of their use of capital. Although they feel there are still substantial growth opportunities in these markets, they are continually

looking to diversity into markets they are not operating in. The Company believes that by continuously diversifying their operations, they can offset the effects of local and regional economic cycles, which enhances their growth potential. However, until a market has shown that it provides significant growth potential and will accept the Company’s products, they will not invest any material resources in real estate, land, overhead, or any other start-up expenses.

D. R. Horton offers high quality homes designed for the first-time and move-up homebuyers. Through all of their acquisitions, the D. R. Horton parent company builds homes under the names: D.R. Horton, Arappco, Cambridge, Continental, Dietz Crane, Dobson, Emerald, Melody, Milburn, Regency, Schuler, SGS Communities, Stafford, Torrey, Trimark and Western Pacific. Generally homes range in size from 1,000 to 5,000 square feet and are priced anywhere from \$80,000 to \$900,000. The Company’s homes are designed by architects in the specific communities to appeal to local styles and preferences. D. R. Horton also provides modifications to the interiors and exteriors of the homes to promote sales efforts. Subcontractors provide essentially all the construction work and usually complete the homes within four months.

D. R. Horton only acquires land after all necessary entitlements have been acquired, so the Company can begin building right away. Before they acquire a piece of land they perform extensive feasibility tests on the soil, independent environmental studies and other engineering work, and they ensure that all local and governmental contracts have been acquired. Usually the Company only purchases lots for exclusive building rights but will sometimes sell certain lots to independent contractors and homebuilders. Their homebuilding segment accounts for approximately 98% of their revenue stream.

Financial Services

The Company provides mortgage-financing services primarily for homes it builds and sells. Through its wholly owned subsidiary, CH Mortgage, the Company provides mortgage banking services in Arizona, California, Colorado, Florida, Georgia, Illinois, Maryland, Minnesota, Nevada, New Mexico, North and South Carolina, Oregon, Texas, Virginia and Washington. DRH Mortgage, LLC, a joint venture formed in 1998 with a third party, provides mortgage origination services in California. As of year-end September 30th, 2002, D. R. Horton provided 72% of the mortgage services for those customers who required mortgage loans. For those states in which D.R. Horton does not provide mortgage services, it works with local mortgage lenders to develop a variety of mortgage plans for its customers. By developing relationships with third party lenders, D. R. Horton has been able coordinate the entire sales process to ensure that loans are received, and closings take place in a timely efficient manner.

Through its subsidiaries, Century Title, Custom Title, DRH Title Company of Texas, Ltd., DRH Title Company of Florida, Inc., DRH Title Company of Minnesota, Inc., Metro Title Company, Principal Title and Travis County Title Company, D.R. Horton also serves as a title insurance agent providing title insurance policies, examination, and closing for the homes it builds in the Austin, Dallas, Fort Worth, Houston, Maryland-D.C., Miami/West Palm Beach, Minneapolis, Orlando, Phoenix, San Antonio and Virginia-D.C. markets.

Both the mortgage financing, and the title insurance agencies account for approximately 2% of D. R. Horton's revenue stream.

Decentralized Operations

D. R. Horton decentralizes their homebuilding operations into separate geographic divisions. Currently they are segmented into 48 separate divisions, some of which are in the same markets. The reason for this decentralization is because management believes division presidents, who are intimately familiar with the area in which they operate, can make better strategical decisions based on their knowledge of the market. Division presidents also receive incentive bonuses based on their operational performance for the year. Because this industry is unusually fragmented for it's size, decentralization has become an industry standard. By letting divisions run themselves like a business, they are able to really establish credibility in the marketplace. Getting acquainted with the major contractors, and becoming familiar with the ways in which the community operates, enable each division to offer a product that is differentiated from other contractors. Because competition is so fierce, and there are so many different large and small competitors, differentiation becomes a major issue in winning contracts.

Industry Analysis

For the past few years, the homebuilding industry has been mainly kept afloat by extremely low interest and mortgage rates. Despite the effects of a recessionary economy, and fear of future terrorist attacks, the housing market has continually grown, reaching an all-time record high in 2001 of 908,000 units. And according to S&P's estimates, housing sales likely broke that record in 2002.

Key Industry Factors

When assessing the overall health of the homebuilding industry, perhaps the most important aspect to look at is the level and direction of interest rates. Interest rates are almost a sure determinant of how companies perform. New home sales have always been known to move in the opposite direction of long-term interest rates. These rates are very difficult to predict however, and are often inaccurate, making it almost impossible for companies to predict sales levels. When evaluating the likely direction of interest rates, market factors are a big determinant. Looking at the level of domestic economic growth and the predicted inflation levels can give one an idea of which direction rates are going. Along with these aspects, it is very important to look at Federal Reserve interest rate policies. After peaking at 8.8% in May 2000, interest rates have spiraled downward. In mid-December, rates were at 5.8%, just above the lowest level in 35 years. For 2003, interest rates are expected to remain relatively constant. Although the industry is directly affected by interest rates, typically rates must be in place for some time before the market directly responds.

Along with interest rates, mortgage rates can be a strong determinant on how responsive consumers are to new housing opportunities. S&P's prediction for mortgage rates is to remain relatively accommodating throughout 2003. In January 2001, which marked the first decline in GDP growth since 1993, the Federal Reserve began to implement an "easing program". In an unsuccessful attempt to ward off an oncoming recession, the Fed cut the Fed funds rate (rate commercial banks charge each other for overnight loans) by 475 basis points. An additional 50 basis point cut was made in November 2002. These actions brought the overall benchmark interest rate down to 1.25% from 6.5%. These cuts have begun to have their intended effect with the GDP bouncing back to show 2.7% growth for 2002, and estimated growth of 3% for 2003. As the economy seemingly rebounds, one can't help but wonder what the effects on the interest and mortgage rates will be. Concerns over the level of these rates might actually help companies such as D. R. Horton, as undecided consumers feel a need to buy homes before rates rise.

The national employment picture also plays an important role in determining housing sales. The employment statistic, which has a direct link to consumer confidence, can help determine the net effect of a rise or fall in interest/mortgage rates. If the employment picture is good, it can offset the effects of rising interest rates as consumer confidence and spending is usually high, if unemployment is still high however, low interest rates may not be the only determinant in a housing decision. During our recession, and after the events of September 11th, we experienced a phenomenal jump in unemployment rates. In April of 2002, we hit a peak of 6%, the highest it's been since August of 1994. However, as the economy begins to rebound, the job market has shown signs of firming. In the first 11 months of 2002, a total of 446,000 were added to the job market as positions were added in every month except September and November.

Another limiting factor in the homebuilding industry is the extensive regulations imposed by local and federal governments. These include a variety of laws pertaining to worker health and safety, zoning, building design, advertising and consumer credit. Homebuilders are also subject to environmental laws and regulations. All of these regulations do the consumer justice by creating a clean, safe environment to work and live, however, for companies it increases the time between acquisitions of land and the start of construction, and also increases the cost of homebuilding. D. R. Horton has done a good job to guard against this as much as possible as they only buy land after all permits, laws, and other requirements have been met.

Company Analysis

The homebuilding industry is expected to remain relatively strong through 2003. But one of the most important aspects of this industry's analysis is how strong company specific factors are. Specifically, the

demographics a company associates itself with, the style of housing it provides, whether it has identified itself in niche markets, and how well diversified its operations are. The best-situated firms in these regards are poised for success in both expansionary and recessionary markets, while poorly situated firms tend to struggle with seasonality. D. R. Horton has diversified itself throughout the United States, and with decentralized operations, they are able to adhere to community specific requests and needs. They have explicitly stated that they primarily cater to first-time and move-up buyers. The niche of the homebuilding market over the next couple of years is expected to be the retirement market, which is expected to grow by 11% from 2003 to 2010. However, the entry-level market, which D. R. Horton specifically adheres to, is expected to record a decent amount of growth. From 2003 to 2010, this market is expected to grow at 5.3%, and at 12% from 2003-2015.

Concerns

The homebuilding industry is not only extremely competitive, but very cyclical as well. Any change to national or local economies, interest/mortgage rates, the employment level, or consumer confidence can have very negative effects on sales. Construction companies are also very vulnerable to any change or availability of land or construction materials, and any adverse weather conditions. These factors can create major delays and inefficiencies for DHI.

I believe that D. R. Horton has successfully diversified its operations throughout the U.S., and has established itself as a credible market player. However, as part of their growth, they have acquired a substantial amount of debt. Such level of debt could prevent this company in the future from being able to receive financing for working capital, capital expenditures, acquisitions, debt service requirements or other requirements. This amount of debt also puts extreme limits to how the company can react in the event of a downturn in the homebuilding market. Their ability to grow the business through acquisitions and profitable niche markets is extremely dependent on the availability of capital. Increases in interest rates, reductions in credit ratings, or any doubts by investors about the market or the economy can severely impact the Company's ability to receive funding for strategic growth objectives.

Although geographically D. R. Horton is diversified, I don't believe they provide enough consumer-oriented diversification. After evaluating the competition, especially Pulte Homes, I found that many of the big players are diversifying their operations to cater to all demographics. D. R. Horton has explicitly stated that they build single and multi-family housing for the first-time and move-up buyers. While this strategy caters to a broad consumer base, they are not specifically targeting such demographic groups that are poised for top growth in the upcoming years. This leads such age groups as the retirement group to look at alternatives for their specific needs. I also believe that the Company's growth strategy is not effectively outlined. They have shown significant financial growth for this year, yet so have their competitors. D. R. Horton states that their primary focus is on internal growth and they will evaluate acquisitional expansion when the opportunity arises. This is not a bad thing, but their level of debt might hinder their flexibility to react to key developments in future markets.

Comparables Valuation

(Company profiles taken from Yahoo Finance)

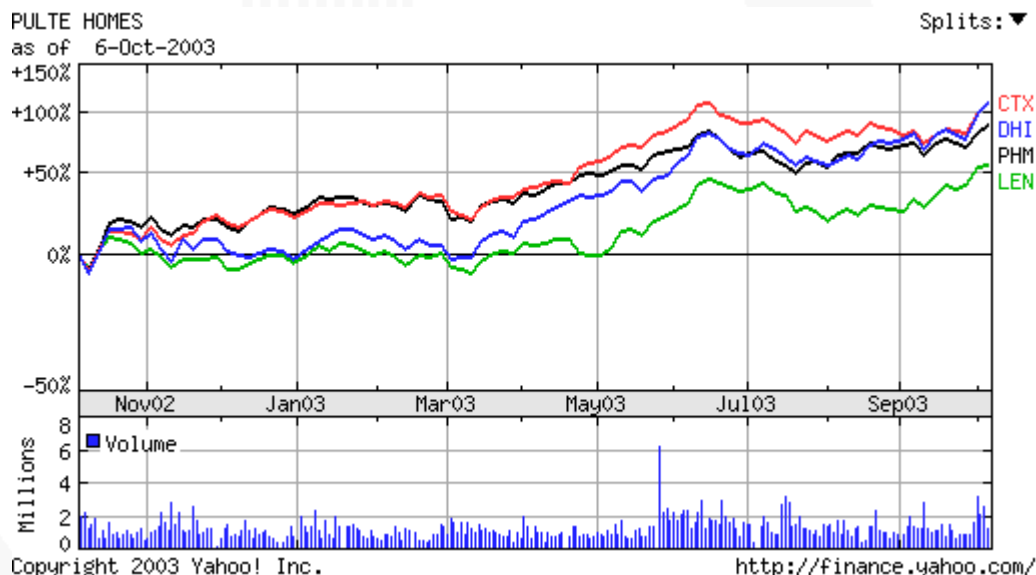
My comparables valuation includes three pure play competitors: Centex Corporation (CTX), Lennar Corporation (LEN), and Pulte Homes (PHM). For my statistical valuation I chose to use Price/Sales,

Price/EBIT, and Price/Debt. These statistics gave DHI an implied share price of \$32.31, which leads me to believe that its current trading price of \$36.35 is overvalued by 11.1%.

Centex Corporation is a residential construction company with operations in five business segments: Home Building, Financial Services, Construction Products, Constuction Services and Investment Real Estate. The Home Building operations involve the purchase and development of land or lots and the construction and sale of single-family homes, townhomes and low-rise condominiums. The Financial Services segment is engaged in the residential mortgage banking business. The Construction Products operations involve the manufacture, production, distribution and sale of cement, gypsum wallboard, recycled paperboard, aggregates and ready-mix concrete. The Construction Services operations involve the construction of buildings for both private and government interests. The Investment Real Estate operations involve the acquisition, development and sale of land, primarily for industrial, office, multi-family, retail, residential and mixed-use projects.

Lennar Corporation has two core businesses, homebuilding and financial services. The Company's homebuilding operations include the sale and construction of single-family attached and detached homes, as well as the purchase, development and sale of residential land directly and through its unconsolidated partnerships. Its financial services subsidiaries provide mortgage financing, title insurance, closing services and insurance agency services for both buyers of its homes and others, and sell the loans they originate in the secondary mortgage market. These subsidiaries also provide high-speed Internet access, cable television and alarm installation and monitoring services to residents of communities the Company develops, as well as other communities.

Pulte Homes, Inc. is a holding company whose subsidiaries are engaged in the homebuilding and financial services businesses. The Company's Homebuilding segment consists of two business units. Domestic Homebuilding is engaged in the acquisition and development of land primarily for residential purposes within the continental United States, and the construction of housing on such land targeted for the first-time, first and second move-up and active adult home buyer groups. International Homebuilding is primarily engaged in the acquisition and development of land primarily for residential purposes, and the construction of housing on such land in Mexico, Puerto Rico and Argentina. The Financial Services segment consists primarily of mortgage banking and title operations conducted through Pulte Mortgage Corporation and other subsidiaries.



Discounted Cash Flow Valuation

For my DCF analysis I used a percentage of sales method. I used an industry average beta of 1.091. With a 10-year T-Bill rate of 3.9% and a Market Risk Premium of 7.0%, I came up with a CAPM of 11.54%. I then used a Return on Debt of 8.5%, a standard tax rate of 35%, along with 52.1% debt and 47.9% equity to calculate a WACC of 8.4%. This all led me to an implied share price of \$25.05. Implying that D. R. Horton is currently 31.1% overvalued.

I forecasted revenues for DHI to increase by 15% next year, then 13%, 9%, 7%, and 5% for the remaining fiscal year of 2008. Based on historical growth rates, outlook for the industry, and the diversified operations of DHI, I believe these to be credible growth rates. The construction industry is extremely vulnerable to many different factors affecting the economy. As the economy begins to rebound, the growth and demand for new construction should be relatively stable.

I have kept both Capital Expenditures, and current assets/liabilities historically stable. As management has not identified a clear growth strategy, it becomes increasingly difficult to allocate resources to future expansion. COGS should not change either, as their gross margin has remained stable at 20%.

Recommendation

D. R. Horton is a strong company with good fundamentals. They have produced strong financial results in the last couple years and continued to provide a quality product to their consumers. Through their acquisitions, they have been able to geographically diversify throughout the entire United States. Yet in a market that is extremely competitive and saturated with a diverse array of market players, I fail to see where DHI will continue to increase shareholder value above a seemingly overvalued price. Because I do not see a clear growth strategy, and because both valuations showed DHI to be overvalued, I am rating this Company a HOLD.



D. R. Horton Incorporated
Exhibit 1
Comparables Valuation

(figures in thousands)

	DHI	CTX	LEN	PHM	Average
Beta	1.091	0.91	0.729	0.757	0.87175
Price	36.85	86.85	83.69	73.65	70.26
Shares Outstanding	157,200	61,760	73,650	61,600	88,553
Market Cap	5,790,000	5,360,000	6,160,000	4,540,000	5,462,500
Sales	6,740,000	9,120,000	7,320,000	7,470,000	7,662,500
EBIT	908,620	1,110,000	1,230,000	817,120	1,016,435
Debt	3,080,000	7,570,000	1,800,000	2,650,000	3,775,000
Valuation Multiples					
Price/Sales	0.86	0.59	0.84	0.61	0.68
Price/EBITDA	6.37	4.83	5.01	5.56	5.13
Price/Debt	1.88	0.71	3.42	1.71	1.95

	Average Indicators of Value	Implied Value
Price/Sales	0.68	29.11
Price/EBITDA	5.13	29.66
Price/Debt	1.95	38.16

Implied Value	32.31
Current Price	36.85

D. R. Horton Incorporated
Exhibit 2
DCF Valuation

(figures in thousands)	2000A	2001A	2002A	2003A	2004E	2005E	2006E	2007E	2008E	
Revenues	3,653,695	4,455,514	6,738,831	8,266,868	9,506,898	10,742,795	11,709,647	12,529,322	13,155,788	
Growth Rate	15.8%	21.9%	51.2%	22.7%	15.0%	13.0%	9.0%	7.0%	5.0%	
Cost of Operations	2,941,109	3,527,142	5,364,428	6,577,632	7,557,984	8,540,522	9,309,169	9,960,811	10,458,851	
%	80.5%	79.2%	79.6%	79.6%	79.5%	79.5%	79.5%	79.5%	79.5%	
Gross Profit	712,586	928,372	1,374,403	1,689,236	1,948,914	2,202,273	2,400,478	2,568,511	2,696,937	
%	19.5%	20.8%	20.4%	20.4%	20.5%	20.5%	20.5%	20.5%	20.5%	
SG&A	395,874	479,400	714,540	904,169	1,026,745	1,160,222	1,264,642	1,353,167	1,420,825	
%	10.8%	10.8%	10.6%	10.9%	10.8%	10.8%	10.8%	10.8%	10.8%	
Total Other Income/Expenses (Net)	8,355	(27,078)	(839)	8,290	4,753	5,371	5,855	6,265	6,578	
%	0.2%	-0.6%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	
EBIT	325,067	421,894	659,024	793,357	926,923	1,047,423	1,141,691	1,221,609	1,282,689	
%	9%	9%	10%	10%	10%	10%	10%	10%	10%	
Interest Expense	15,843	14,097	11,517	10,338	14,260	16,114	17,446	17,981	19,487	
%	0.43%	0.32%	0.17%	0.13%	0.15%	0.15%	0.15%	0.14%	0.15%	
Pretax Income	309,224	407,797	647,507	783,019	912,662	1,031,308	1,124,244	1,203,628	1,263,202	
%	8.5%	9.2%	9.6%	9.5%	9.6%	9.6%	9.6%	9.6%	9.6%	
Tax Expense	117,505	152,924	242,815	355,207	337,685	381,584	415,970	445,342	467,385	
Tax Rate	38%	38%	37%	45%	37%	37%	37%	37%	37%	
Net Income	191,719	257,009	404,692	427,812	574,977	649,724	708,274	758,286	795,817	
%	5.2%	5.8%	6.0%	5.2%	6.0%	6.0%	6.0%	6.1%	6.0%	
Add Back										
Depreciation and Amortization	24,492	36,062	40,645	50,389	61,795	69,828	76,113	81,441	85,513	
%	0.67%	0.81%	0.60%	0.61%	0.65%	0.65%	0.65%	0.65%	0.65%	
Interest Expense(1-t)	9,823	8,811	7,198	5,648	8,984	10,152	10,991	11,328	12,277	
Operating Cash Flow	226,034	301,882	452,535	483,849	645,756	729,704	795,378	851,054	893,607	
Current Assets	2,383,140	3,043,660	4,447,410	5,593,538	6,322,087	7,090,245	7,728,367	8,269,352	8,682,820	
%	65.2%	68.3%	66.0%	66.5%	66.5%	66.0%	66.0%	66.0%	66.0%	
Current Liabilities	375,347	508,749	848,388	975,000	1,121,814	1,267,650	1,381,738	1,478,460	1,552,383	
%	10.3%	11.4%	12.6%	11.8%	11.8%	11.8%	11.8%	11.8%	11.8%	
Change in NWC	63,990	527,118	1,064,111	1,019,516	581,735	622,322	524,034	444,264	339,545	
%	1.8%	11.8%	15.8%	12.3%	6.1%	5.8%	4.5%	3.5%	2.6%	
Capital Expenditures	15,789	33,368	39,818	41,245	47,534	53,714	58,548	62,647	65,779	
%	0.43%	0.75%	0.59%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	
Free Cash Flow	\$146,255	(\$258,604)	(\$651,394)	(\$576,912)	\$16,486	\$53,669	\$212,796	\$344,144	\$488,283	
PV					15,208.06	45,669.41	167,039.23	249,199.09	326,159.76	6,215,730.17

Beta	1.091
Risk free rate	3.9%
Market risk premium	7.0%
Return on debt	8.5%
% debt	52.1%
% equity	47.9%

CAPM	11.54%
WACC	8.40%
Terminal Growth Rate	3.00%
PV of Terminal Value	6,215,730
PV of Forecasted CF	803,276
Total PV of Cash Flows	7,019,006
Long term debt	3,081,032
Shares Outstanding	157,200
Implied Price	\$25.05