Smith Douglas Homes Corp.

Impressive returns and growth priced into premium valuation; Initiate at Neutral

Initiating Coverage: NEUTRAL | PO: 28.00 USD | Price: 26.10 USD

05 February 2024

Equity

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Share gaining homebuilder; Initiate at Neutral with $28 PO

We initiate on Smith Douglas Homes (ticker: SDHC) at Neutral with a price objective of $28 (7% upside). Smith Douglas sells entry level ($343K average selling price in 2022), built-to-order homes throughout the Southeastern US. The company built its first house in 2008 in Atlanta and has rapidly expanded to a top 40 US market share position in seven markets. SDHC priced its initial public offering at $21 per share on January 10.

Asset-light model drives impressive ROE and growth

SDHC purchases nearly 100% of its land through option contracts reducing the capital it needs for land inventory and providing the company with a greater degree of flexibility on its lot position. We expect SDHC to maintain 25%+ return-on-equity (vs. 20% public homebuilder average) as a result of its balance sheet efficiency and disciplined land buying strategy. We expect SDHC's high ROE and strong balance sheet (-1.0x 2024E net debt/EBITDA) to be reinvested in growth and forecast 30%+ book value growth in 2025.

High growth builder, expanding in Southeast and Texas

SDHC has emerged as a top builder in the Southeast. It's in 7 metro areas in 5 states including Alabama, Georgia, North Carolina, Tennessee, and Texas. It has grown to the 6th-largest builder in (4% share) in Atlanta (43% of 2023E closings) and 10th in Nashville. With the 2023 purchase of Devon Street Homes, it gained a new market, Houston. Thus, SDHC is well positioned to continue its strong growth trajectory with nearly 12k lots under control (89% option). We forecast a 20% deliveries CAGR from 2022 to 2025E.

Proprietary software supports industry leading cycle times

Smith Douglas uses a proprietary workflow and ERP system that results in one of the lowest build cycles in the industry (just 80 calendar days). Its more efficient building process supports elevated gross margin and inventory turns.

Higher ROE reflected in current valuation

Our $28 PO is based on 3.4X price-to-tangible book (implies 15x 2024E P/E), a significant premium to 2.0X avg peer group, which is justified by Smith Douglas's higher return-on-equity profile and growth outlook. While we are constructive on SDHC's asset-light model and growth, we expect ROE to decline near-term to roughly 25% (albeit off an exceptionally high level) as it integrates Devon Street and gains scale in new markets.

Estimates (Dec) (US$)	**2022A**	**2023E**	**2024E**	**2025E**
EPS	2.35	1.96	1.82	2.55
GAAP EPS	3.13	2.61	2.34	3.28
EPS Change (YoY)	NA	-16.6%	-7.1%	40.1%
DPS	0	0	0	0
Valuation (Dec)				
P/E	11.1x	13.3x	14.3x	10.2x
GAAP P/E	8.3x	10.0x	11.2x	8.0x
EV / EBITDA*	10.1x	12.0x	11.1x	8.0x
Free Cash Flow Yield*	9.5%	5.2%	4.0%	3.5%

* For full definitions of *iQmethod* SM measures, see page 18.

Stock Data

Price	26.10 USD
Price Objective	28.00 USD
Date Established	5-Feb-2024
Investment Opinion	C-2-9
52-Week Range	23.26 USD - 27.29 USD
Mrkt Val (mn) / Shares Out (mn)	1,375 USD / 52.7
Free Float	15.0%
Average Daily Value (mn)	NA
BofA Ticker / Exchange	SDHC / NYS
Bloomberg / Reuters	SDHC US / SDHC.N
ROE (2023E)	46.8%
Net Dbt to Eqty (Dec-2022A)	-8.9%

Timestamp: 05 February 2024 06:00AM EST

iQprofile SM Smith Douglas Homes Corp.

*iQ*method SM – **Bus Performance***

(US$ Millions)	2022A	2023E	2024E	2025E
Return on Capital Employed	56.0%	35.3%	24.5%	24.5%
Return on Equity	81.1%	46.8%	28.8%	25.8%
Operating Margin	18.5%	15.7%	13.3%	13.4%
Free Cash Flow	131	71	55	48

*iQ*method SM – **Quality of Earnings***

(US$ Millions)	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.3x	0.8x	0.6x	0.4x
Asset Replacement Ratio	1.2x	1.3x	1.1x	1.2x
Tax Rate	25.0%	25.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	-8.9%	23.4%	-27.4%	-22.9%
Interest Cover	NA	NA	NA	NA

Income Statement Data (Dec)

(US$ Millions)	2022A	2023E	2024E	2025E
Sales	755	744	958	1,328
% Change	NA	-1.4%	28.7%	38.7%
Gross Profit	223	208	248	334
% Change	NA	NA	NA	NA
EBITDA	145	121	131	182
% Change	NA	-16.1%	7.9%	39.1%
Net Interest & Other Income	1	0	1	3
Net Income (Adjusted)	**105**	**88**	**96**	**135**
% Change	**NA**	**-16.7%**	**9.5%**	**40.7%**

Free Cash Flow Data (Dec)

(US$ Millions)	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	105	88	96	135
Depreciation & Amortization	1	1	1	1
Change in Working Capital	(13)	(47)	(69)	(126)
Deferred Taxation Charge	NA	NA	NA	NA
Other Adjustments, Net	39	31	28	39
Capital Expenditure	(1)	(2)	(1)	(1)
Free Cash Flow	**131**	**71**	**55**	**48**
% Change	**NA**	**NA**	**NA**	**NA**
Share / Issue Repurchase	(8)	(4)	0	0
Cost of Dividends Paid	NA	NA	NA	NA
Change in Debt	(58)	39	(60)	0

Balance Sheet Data (Dec)

(US$ Millions)	2022A	2023E	2024E	2025E
Cash & Equivalents	30	16	124	135
Trade Receivables	NA	NA	NA	NA
Other Current Assets	178	287	363	491
Property, Plant & Equipment	1	2	2	2
Other Non-Current Assets	14	30	31	34
Total Assets	**223**	**335**	**520**	**663**
Short-Term Debt	15	55	0	0
Other Current Liabilities	20	27	34	42
Long-Term Debt	0	10	0	0
Other Non-Current Liabilities	23	32	32	30
Total Liabilities	**59**	**124**	**66**	**72**
Total Equity	**165**	**211**	**455**	**591**
Total Equity & Liabilities	**223**	**335**	**520**	**663**

* For full definitions of *iQmethod* SM measures, see page 18.

Company Sector

Homebuilders

Company Description

Smith Douglas is a Southeast focused, entry-level homebuilder. In 2022, the company closed 2.2k homes, making it the 20th largest private builder in the US. Smith Douglas operates in 8 markets in 5 states. Currently, Smith Douglas is the 6th largest builder in Atlanta (4% share) and 10th largest builder in Nashville (3% share)..

Investment Rationale

We rate SDHC shares at Neutral. While we are constructive on SDHC's asset-light model, growth outlook and industry leading build cycles, we see limited further upside given we expect ROE to decline near-term (albeit off an exceptionally high level) as: (1) SDHC integrates the Devon Street acquisition, (2) SDHC expands into adjacent or new markets where it does not yet have scale, and (3) higher price land flows through SDHC's income statement, which will put downward pressure on gross margins.

Stock Data

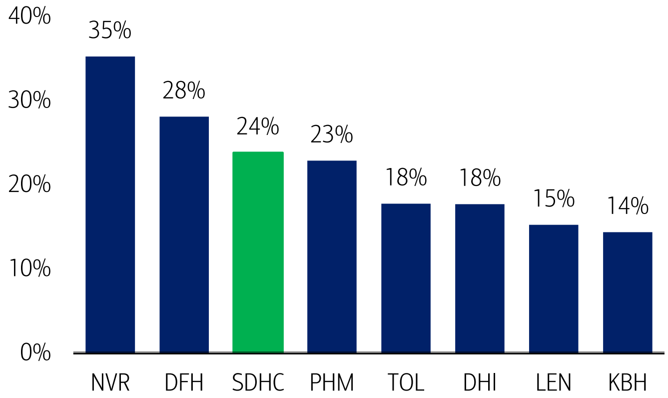
Average Daily Volume	NA

Quarterly Earnings Estimates

	2022	2023
Q1	NA	0.48A
Q2	NA	0.51A
Q3	NA	0.57A
Q4	NA	0.39E

Focus charts

Exhibit 1: SDHC has one of the highest ROEs among the peer group
BofA 2024 Homebuilder ROE estimates



Source: BofA Global Research estimates. Note: SHDC average equity uses IPO share pro forma

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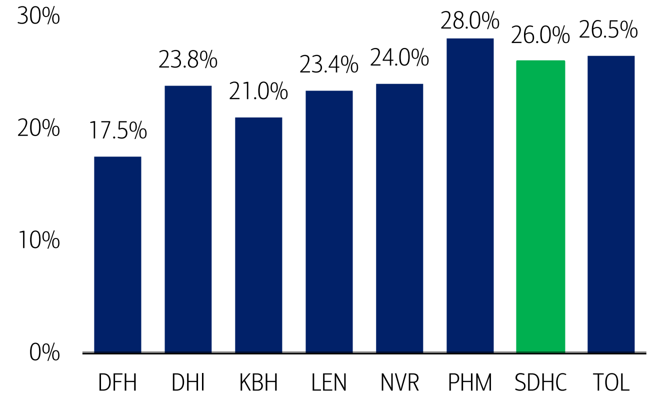
Exhibit 2: SDHC has one of the highest gross margins in the industry
BofA 2024 Homebuilder gross margin estimates



Source: BofA Global Research estimates

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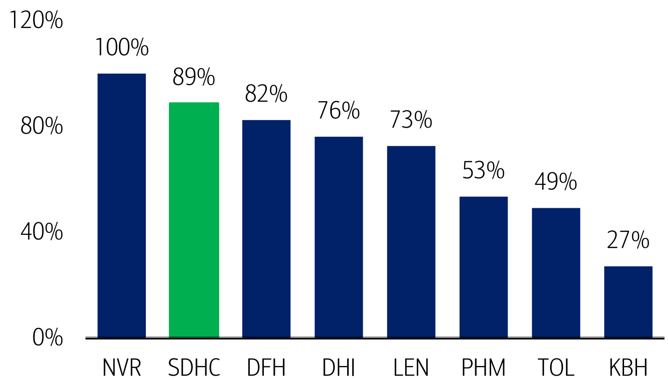
Exhibit 3: 89% of SDHC's lots are optioned
Percent of public homebuilders' optioned lots



Source: Company reports

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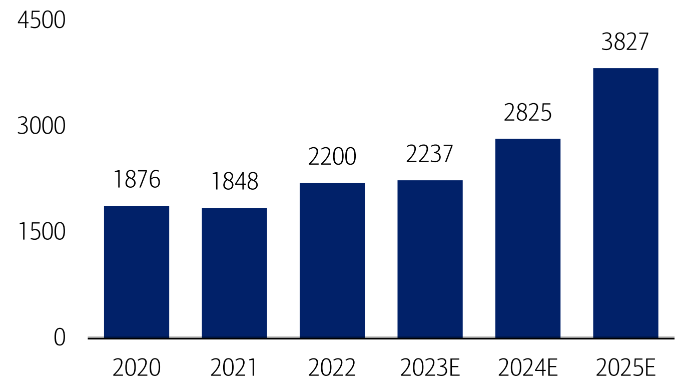
Exhibit 4: Closings are expected to accelerate in 2024/2025
SDHC home closings from 2020 to 2025 estimates



Source: BofA Global Research estimates, company filings

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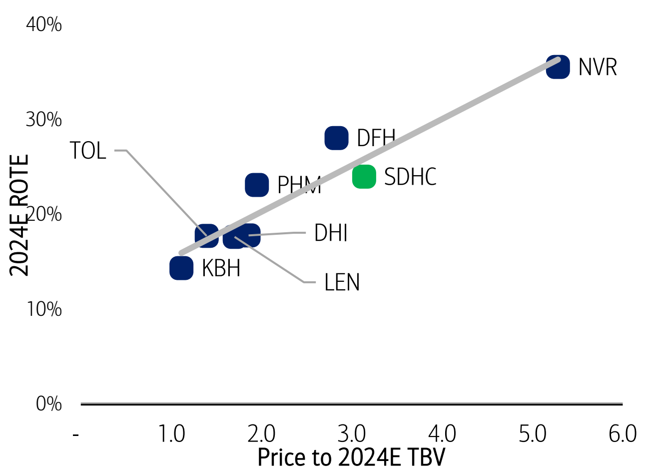
Exhibit 5: SDHC trades at a premium vs. peers
Homebuilder ROTE and P/TB (based on 2024 estimates)



Source: Company data, BofA Global Research estimates

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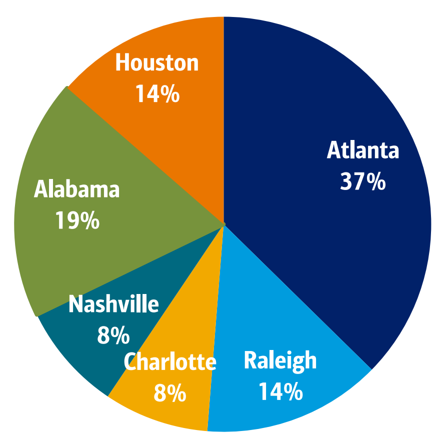
Exhibit 6: We expect Atlanta to continue to be largest market for SDHC
Closings by market (based on 2024 estimates)



Source: BofA Global Research estimates

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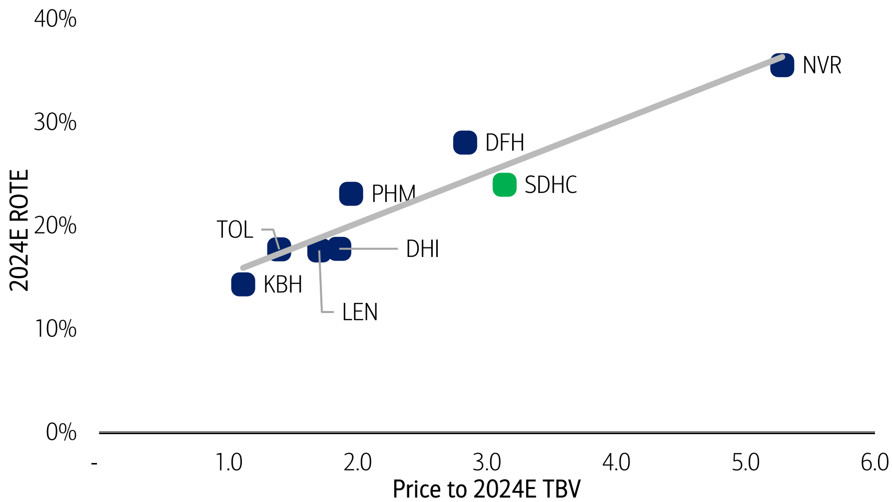
Initiate at Neutral

Higher return builder, but already trading at a premium

We initiate on Smith Douglas with a Neutral rating and $28 price objective. Smith Douglas currently trades at 3.4x price-to-tangible book, a meaningful premium to the peer group average of 2.0x. We believe the premium is justified as homebuilders with higher return-on-equity should trade at price-to-book ratios and we expect Smith Douglas to consistently generate the highest ROE among its peer group.

While we are constructive on SDHC's asset-light model, growth outlook and industry leading build cycles, we see limited further upside to the multiple from current levels given we expect ROE to decline near-term (albeit off a very high level) as: 1) SDHC integrates the Devon Street acquisition (estimate 14% of 2024 closings), 2) expands into adjacent or new markets where it does not yet have scale, and 3) higher priced land flows through SDHC's income statement, which will put some downward pressure on gross margins.

Exhibit 7: Homebuilder ROTE and P/TB (based on 2024E)
SDHC has one of the highest ROEs, but trades at a premium vs. peers



Source: Company data, BofA Global Research estimates

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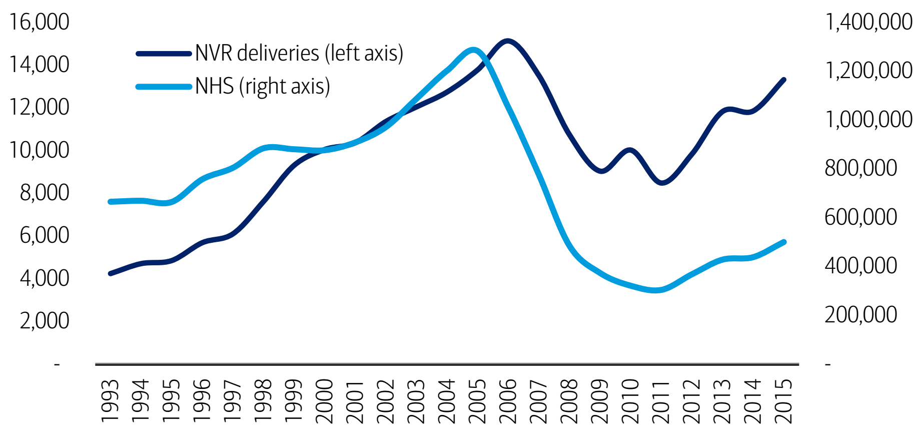
Target multiple is well above group, in-line with Dream Finder's Homes

Our PO is based on 3.4x 2024E price-to-tangible book (implies 15x 2024E P/E), which is a substantial premium to the current peer group average of 2.0x due to SDHC's faster growth outlook and higher ROE. Our target multiple is also a slight premium to Dream Finder's Homes (trades at ~2.8x) which has a similar return-on-equity profile but carries more leverage than SDHC. Similar to Dream Finder's Homes, Smith Douglas is growing its tangible book value rapidly as it reinvests in growth and we forecast ~30% YoY growth in tangible book value in 2025.

NVR is an aspirational valuation comp longer term

Smith Douglas has many of the same characteristics as NVR, which trades at a multiple of any public homebuilder (>5x price-to-book). Like SDHC, it has an asset light strategy and operates in a small number of markets. NVR trades at the highest multiple among public homebuilders and we think SDHC should trade at a discount to the company (at least for now). In our view, NVR's stock re-rating was driven by the company's ability to take market share and generate industry leading ROE during one of the most severe economic downturns in history. In other words, NVR's execution during the global financial crisis was very strong, with only one quarter of negative earnings versus a group that suffered multiple years of losses. Outperformance was driven by the company's ability to operate a predominantly organic, asset light strategy (limits balance sheet risk), within a tight grouping of mostly contiguous markets where it commands dominant share and has the ability to efficiently supply job sites with structural components from its offsite manufacturing facilities. It was also a function of NVR's deep, long-standing relationships with land developers in its key markets, the company's discipline to maintain low financial leverage and its commitment to consistently align itself with shareholders through sizable stock repurchases. Finally, NVR is the 4th-largest US homebuilder despite only operating in a few major markets, which gives it an almost dominant market share position in its core markets. SDHC will need to grow and gain scale in many of its new and adjacent markets, which will initially carry lower margins and ROE.

Exhibit 8: NVR tripled in size from 1993-2015, despite a declining market
NVR's growth has been impressive and not always supported by the market



Source: Company Filings; Census Bureau

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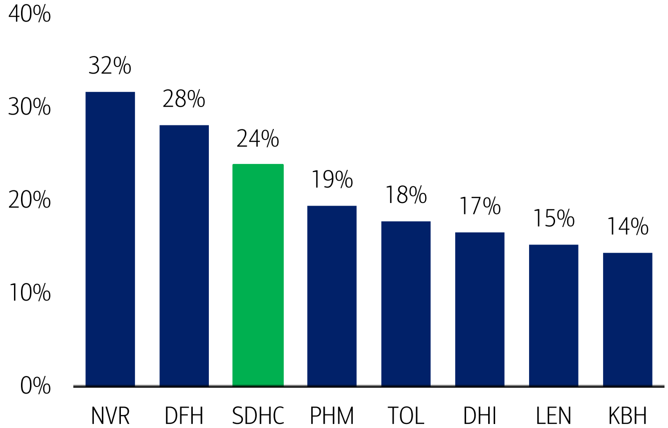
Investment positives

Option and asset-light model supports higher ROE

Land strategy focused on options and finished lots, drives higher ROE

SDHC operates a land-light strategy, with roughly 89% of its lots controlled under option. This asset-light strategy results in less capital being tied up in land, reduces balance sheet risk, increases inventory turnover and efficiency, and enhances ROE. To accomplish this, the company enters into purchase agreements with developers of finished land, and in return for what is generally a less than 10% deposit (higher if using a land banker), gains the exclusive right to acquire specific lots. In our view, this approach provides SDHC with a degree of flexibility and reduces the amount of capital it has allocated toward land inventory at any given time. As a result of this balance sheet efficiency, SDHC's ROE is higher than most of its peers and more in-line with other asset-light builders (NVR and DFH).

Exhibit 9: BofA 2024 Homebuilder ROE estimates
SDHC has one of the highest ROEs among the peer group



Source: BofA Global research estimates

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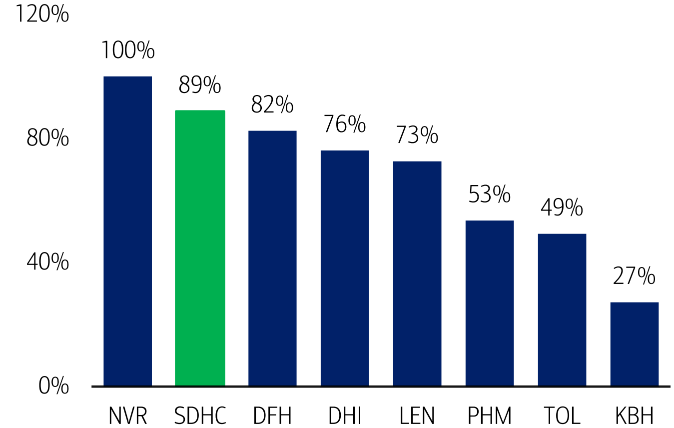
Exhibit 10: % optioned lots
89% of SDHC's lots are optioned



Source: Company reports

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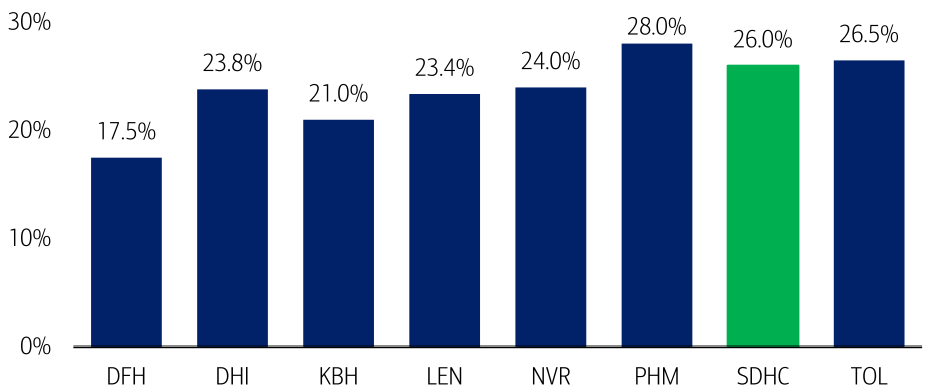
SDHC proprietary software support shorter build cycles and inventory turns

SDHC utilizes a proprietary workflow and ERP system to drive one of the lowest build cycle times in the industry (~60 business days, ~80 calendar days). This system is differentiated through its Rteam production model and Smart Build ERP system which supports the workflow of trade labor. Smart Build was purpose-built by SDHC founder Tom Bradbury as a construction-management focused, single database ERP system. The system provides immediate access to information around scheduling. Many builders manage this process without using a centralized database that trade labor can access. This process is scalable and enables more efficient workflow for Smith Douglas and its trades, which results in a more consistent trade base (SDHC is often the vast majority of their trades work). Finally, while SDHC is a built-to-order builder, 90% of home closings come from just 30 floor plans which increases building efficiency.

Exhibit 11: 2024E Homebuilder Gross Margin
SDHC has one of the highest gross margins in the industry



Source: BofA Global Research estimates

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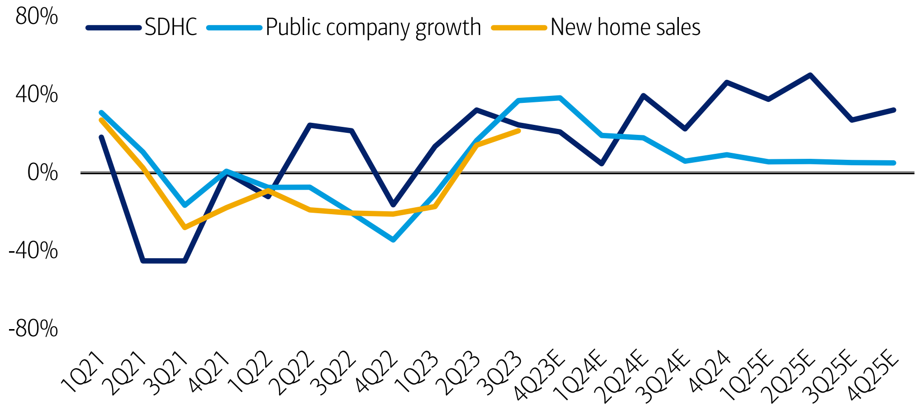
Strong growth outlook with track record of share gains

SDHC has significantly outpaced the market

SDHC ranked #38 nationally on the Builder 100 in 2022 (up from 54th in 2017) and its increased significantly since its launch in 2008.

While the company has grown much faster than most public homebuilding peers over the past few years, that has come off of a much lower base. We expect continued outperformance (supported by the recent Devon Street acquisition). We forecast a 20% deliveries CAGR from 2022 to 2025E.

Exhibit 12: Homebuilder order growth rates
SDHC orders to trend ahead of the industry going forward



Source: Census Bureau, company data, BofA Global Research estimates

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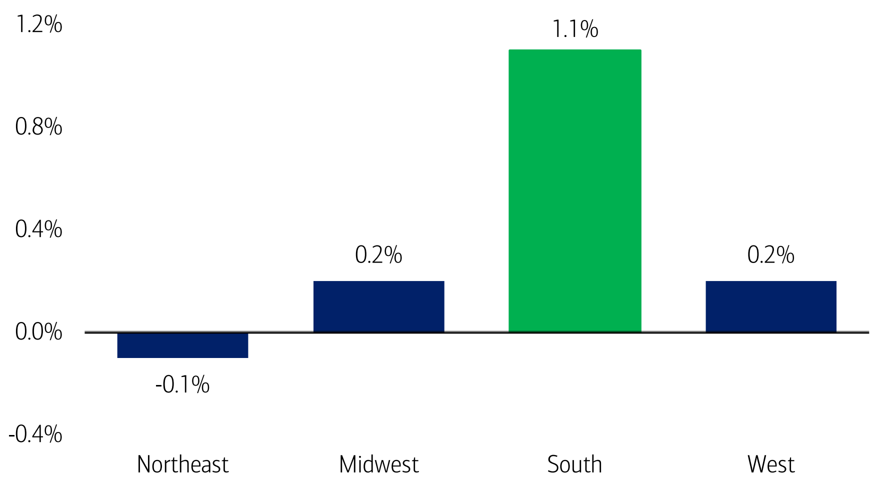
Attractive market exposure

Smith Douglas is concentrated in Southeast US and currently operates in seven markets including in five of the top 16 markets: Houston (#2), Atlanta (#5), Charlotte (#8), Raleigh (#15) and Nashville (#16). While SDHC's national market share is relatively low, its local market share is meaningful in some of its core markets. It's the 6th-largest builder in Atlanta (4% share) and the 10th-largest builder in Nashville (3% share). We expect housing demand in Smith Douglas's largest markets to continue to benefit from positive in-migration. The US Census Bureau data indicates that the South region of the US had the strongest population growth from July 2022 t0 July 2023 (+1.1% YoY).

Exhibit 13: The South region had the highest percent change YoY
Population change by region between July 2022 and July 2023



Source: Census Bureau

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Exhibit 14: Largest homebuilder markets by closings (2022)
SDHC operates in 5 of the top 16 markets (SDHC markets highlighted below)

2022 Market Ranking	Market
1	Dallas-Fort Worth-Arlington, TX
2	**Houston-The Woodlands-Sugar Land, TX**
3	Phoenix-Mesa-Chandler, AZ
4	Austin-Round Rock-Georgetown, TX
5	**Atlanta-Sandy Springs-Alpharetta, GA**
6	San Antonio-New Braunfels, TX
7	Tampa-St. Petersburg-Clearwater, FL
8	**Charlotte-Concord-Gastonia, NC-SC**
9	Riverside-San Bernardino-Ontario, CA
10	Washington-Arlington-Alexandria, DC-VA-MD-WV
11	Las Vegas-Henderson-Paradise, NV
12	Orlando-Kissimmee-Sanford, FL
13	Jacksonville, FL
14	Denver-Aurora-Lakewood, CO
15	**Raleigh-Cary, NC**
16	**Nashville-Davidson--Murfreesboro--Franklin, TN**

Source: Builder Magazine

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Consistent track record of market expansion

SDHC started its first home in Atlanta in 2008 and has primarily expanded in the Southeast. We anticipate that the majority of the company's growth going forward will come from existing or adjacent markets. We believe new market expansion will be focused on Texas following the Devon Street Homes acquisition in Houston, TX in July 2023.

- 2009: Started in **Atlanta, GA**
- 2016: Opened **Raleigh, NC** and **Birmingham, AL**
- 2017: Opened **Nashville, TN** and **Charlotte, NC**
- 2020: Opened **Dalton, GA** and **Huntsville, AL**
- 2023: Entered **Houston, TX** with the acquisition of Devon Street Homes

Exhibit 15: SDHC held solid market share in the Atlanta and Nashville
SDHC was the 6th largest builder in Atlanta in 2022; #10 in Nashville

Market	Market Ranking in US	SDHC Market Ranking (2022)	SDHC 2022 Market Share
Atlanta	#5	#6	4%
Nashville	#16	#10	3%

Source: Builder Magazine

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Devon Street acquisition expands presence in Texas market

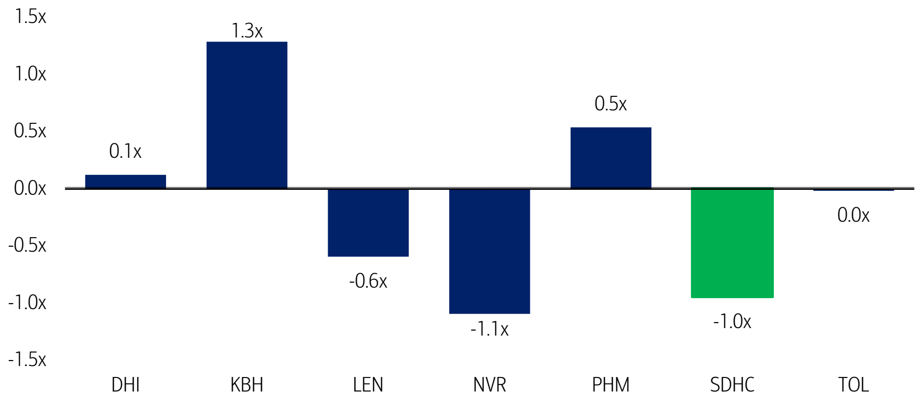
New home construction is also heavily weighted to the Southeast/Texas where the cost of living and taxes are more attractive and job growth is stronger. In addition, land availability, construction costs and municipal approval processes tend to be more attractive in these regions. Texas had 4 of the top 6 markets by closings in 2022.

Prior to 2023, SDHC had no exposure to Texas. In July, they announced the acquisition of Devon Street Homes for $80mm. The deal will give SDHC a strong presence in Houston. As of 2022, Devon Street had 1,221 lots under control (roughly three years of supply).

Strong balance sheet

SDHC has built a strong balance sheet. The proceeds from the company's IPO are expected to be used to pay down construction loans and management expects no debt at the end of 2024. We are forecasting a negative-to-capital ratio at the end of 2024, well below the longer-term homebuilder average.

Exhibit 16: Net Debt/Adjusted EBITDA (2024E)
We expect SDHC with a net cash position



Source: BofA Global Research estimates

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New home demand remains resilient

In December 2023, new home sales (seasonally adjusted annualized rate) increased to 664k, compared to November sales of 615K, (+8.0% MoM) and 636K in December 2022 (+4.4% YoY). December 2023 new home inventory increased to 453K, a gain of +0.4% YoY on a monthly basis. Months of inventory fell to 8.2 in December compared to 8.8 in October, and fell (6.8%) MoM, and decreased (3.5%) YoY on a monthly basis. Median home prices for new homes fell to $413,200, (3.0%) MoM and (13.8%) YoY.

Exhibit 17: New Home sales trends
New Home sales rose in December, +8% MoM and +4.4% YoY

New Home sales	Sep.	Oct.	Nov.	Dec.	2023	Long-term average*
SAAR	698	676	615	664	668	706
MoM change	6.7%	-3.2%	-9.0%	8.0%	N/A	0.2%
Monthly YoY change	23.1%	17.2%	5.7%	4.4%	4.2%	0.8%
Median new single family home price (Thousands)	$426.1	$414.6	$426.0	$413.2	$427.4	N/A
YoY change in median price	-10.8%	-16.5%	-7.9%	-13.8%	-6.6%	5.7%
New home inventory seasonally adjusted (SA) (months)	7.5	7.8	8.8	8.2	7.9	5.9

Source: BofA Global Research, US Census Bureau, Haver Analytics
* Jan 1999-December 2023

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New home sales benefitting from lack of existing home inventory

Total home inventory fell to 1.32mm as new home inventory slightly increased and existing home inventory declined in December. Existing home inventory is still low compared to its historical average largely due to elevated mortgage rates and the "lock-in effect," in which homeowners with low-rate mortgages are staying put rather than selling. New homes are now tracking near a record high percentage of the total inventory of homes available at 34% in December, up from 31% in November.

Exhibit 18: New home inventory as a % of total inventory
New home inventory rose to 34% of total inventory in December 2023, up +10% MoM from November

Source: BofA Global Research, Census Bureau, National Association of Realtors, Haver Analytics
Data through December 2023

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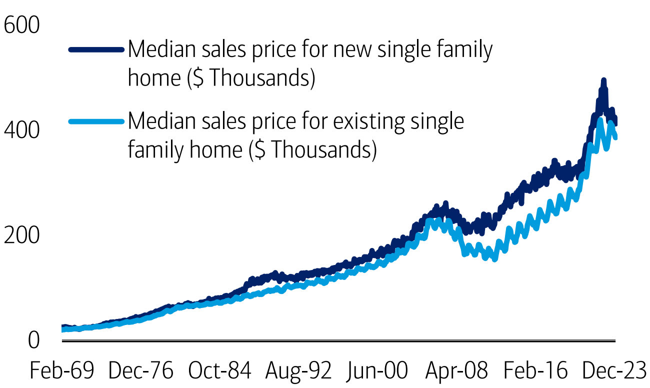
Spread between new and existing home prices has narrowed

In February 2012, the premium on new home sales peaked at 53.7% versus the median existing home sales price, as builders slowed the pace of new construction and existing home prices fell. Since then, the spread has narrowed between new and existing median home prices since new home median price decreased (3.0%) MoM and existing home median price fell (1.3%) MoM. New home prices were at a 6.8% premium in December 2023, down from an 8.6% premium in November.

Exhibit 19: Median sales prices of new homes vs existing homes
In December, the median sales price of new homes decreased (14%), YoY, while existing family homes increased 4.4% YoY



Source: BofA Global Research, Census Bureau, Haver Analytics
Data through November 2023

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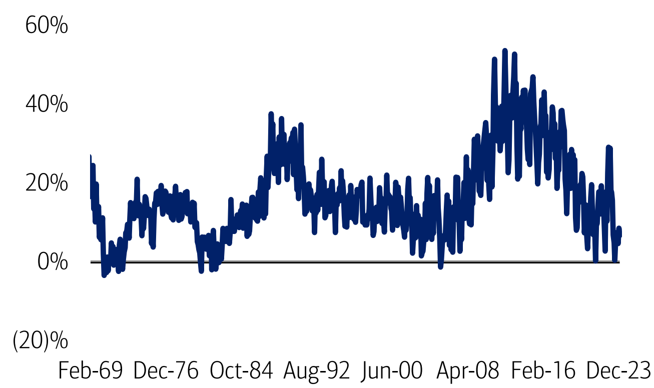
Exhibit 20: Price premium of new homes vs existing homes
The new home median price is 6.8% higher than existing homes price in December



Source: BofA Global Research, Census Bureau, Haver Analytics
Data through December 2023

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Investment risks

Ownership structure, including UP-C structure

Smith Douglas (SDHC) launched as a holding company in Smith Douglas Holdings LLC, in which the public company owns ~17% of Smith Douglas Holdings LLC and the remaining 83% is owned by the Continuing Equity Owners. As part of the UP-C structure, Smith Douglas will make distributions to members for tax purposes, which limit cash and flow generation. To adjust for this distribution, we have calculated a cash EPS figure for the company in addition to the adjusted EPS (25% tax rate on net income) reported by SDHC. For 2024, we expect cash EPS of $1.62 vs. adjusted net income of $1.82.

In addition to owning ~83% Class A shares, Continuing Equity Holders were also issued Class B shares and have ~98% of the voting power, limiting public shareholder influence.

Low liquidity in the stock could pressure valuation

Given the smaller size of the public offering and the current market capitalization (~$1.4B), we expect lower trading liquidity, which could pressure valuation and increase volatility. Recent average daily trading volume has been around $2M.

Low market share on a national basis

Smith Douglas is nationally ranked 38th on Builder 100 in 2022 (up from 54th in 2017) and 20th largest private builder in the U.S.

Exhibit 21: 2022 Homebuilder rankings
SDHC is the 38th largest builder in the US

2023 Rank	Company	2022 Closings	2023 Rank	Company	2022 Closings
1	D.R. Horton (p)	82930	21	DRB Group	4282
2	Lennar Corp. (p)	68817	22	Rausch Coleman Homes	4103
3	PulteGroup (p)	29111	23	Mattamy Homes	3965
4	NVR (p)	22732	24	Highland Homes	3700
5	Meritage Homes Corp. (p)	14106	25	Perry Homes	3693
6	KB Home (p)	13738	26	The Villages of Lake Sumter	3606
7	Taylor Morrison (p)	12647	27	Shea Homes	3428
8	Clayton Properties Group	11751	28	Habitat for Humanity International	3421
9	Century Communities (p)	10594	29	Adams Homes	3135
10	Toll Brothers (p)	10515	30	Fischer Homes	3105
11	M.D.C. Holdings (p)	9710	31	DSLD Homes	3088
12	Ashton Woods Homes	8591	32	Green Brick Partners (p)	2916
13	M/I Homes (p)	8366	33	Maronda Homes	2755
14	Dream Finders Homes (p)	6878	34	Brightland Homes	2639
15	LGI Homes (p)	6621	35	Landsea Homes (p)	2527
16	Hovnanian Enterprises (p)	6090	36	Drees Homes	2364
17	Tri Pointe Homes (p)	6063	37	Woodside Homes	2269
18	David Weekley Homes	5270	38	Smith Douglas Homes (p)	2200
19	Beazer Homes (p)	4756	39	AMH (p)	2183
20	Stanley Martin Homes	4426	40	Bloomfield Homes	2118

Source: Builder Magazine; (p) denotes publicly traded homebuilder

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While SDHC operates in 5 of the top 16 markets, these markets are some of the most competitive in the US. SDHC has top 10 market share in just two of these areas (#6 in Atlanta and #10 in Nashville). Local market share is important for operating efficiency and scale.

Execution risks associated with a high growth builder and new market entry

SDHC recently entered the Houston market through the acquisition of Devon Street Homes and plans to expand into additional markets. Gross margin and returns typically trend below the company average (we estimate high-teens initially) until the company can reach scale (we think it will take 2-3 years). If SDHC continues its aggressive moves into new markets, we would expect this to be a drag on margins and returns in the near-term. SDHC's R-team production model is a competitive advantage, but it needs scale to attract trade labor.

Integration of M&A

While SDHC has been successful entering adjacent markets, Devon Street is the first major acquisition for the company – and it may pose some challenges. Houston is not an adjacent market to SDHC's legacy markets. Furthermore, Devon Street's land purchases are not 100% optioned and it has focused on quick move-in homes. SDHC will need to deliver the backlog of the legacy Devon Street business while transitioning the company to SDHC's superior building process and capital efficiency option model.

Housing cycle risks/macro

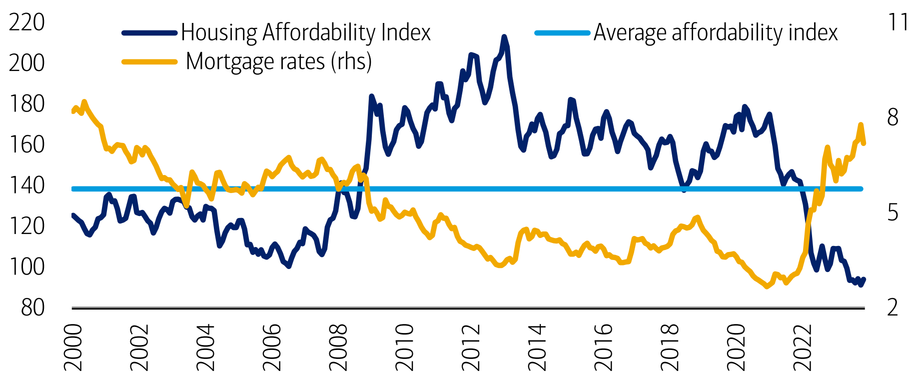
Housing Affordability remains under pressure

The Housing Affordability Index was reported by National Association of Realtors (NAR) at 94.2 in November, tracking at 32% below the historical average of 138.6. In November, mortgage rates fell to 7.22% from a peak of 7.79% in October, causing the affordability index to rise. The National Association of Realtors (NAR) affordability index was down (7.5%) YoY in November but rose 3.1% MoM.

Worsening affordability could pose a challenge for SDHC as it primarily sells homes for under $350K marketed to first-time buyers.

Exhibit 22: Housing Affordability Index vs mortgage rates

Affordability still down (7.5%) YoY, but up 3.1% MoM in November when mortgage rates started to fall



Source: BofA Global Research, Haver Analytics, FHLMC Note: Contract interest rates on commitments for 30-year fixed-rate first mortgages. Prime mortgages only.
Data through November 2023

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Higher rates also usually a headwind for homebuilder stocks

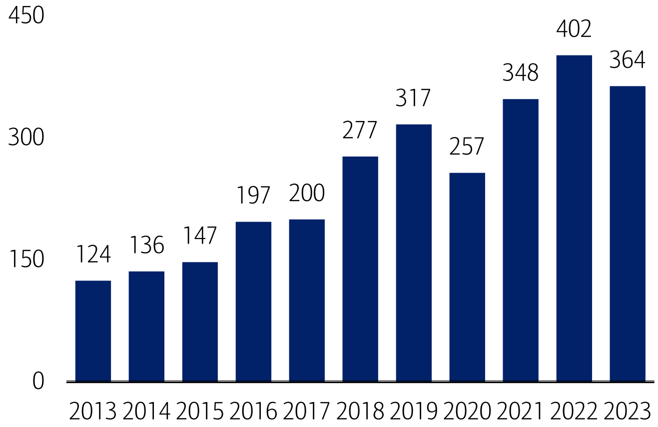
If interest rates do not decline in 2024, we would expect homebuilder stocks to be negatively impacted. Higher and more volatile interest rates, particularly mortgage rates, create unease among homebuilding investors, given the real and perceived impact on affordability, as history shows.

Homebuilder stocks historically have maintained an inverse relationship with mortgage rate movements. When mortgage rates rose from 5.53% on June 30, 2005 to 6.80% on July 20, 2006, the Philadelphia Stock Exchange Housing Sector Index (HGX) index plummeted 28%. After the Federal Reserves "taper talk" drove mortgage rates up from 3.35% on May 2, 2013 to 4.58% on August 22, 2013, housing stocks also sold off by roughly 14%. In 2018, rate hikes throughout the year pushed mortgage rates up by roughly 100bps to the highest level since 2011 (4.8%) – homebuilder stocks declined approximately 20% for the year.

Cost inflation driven by labor and land costs will weigh on margins

Public builders have repeatedly cited labor shortages as among the biggest long-term concerns for the industry. Construction job openings have increased over the last 4 years and spiked again in September 2023, hitting 431K openings, according to the U.S. Bureau of Labor Statistics. This labor shortage has caused significant inflation in homebuilder labor costs with average hourly earnings for construction workers and framing contractors, over the same period, increasing at an average annual pace of 4% and 5%, respectively. Today construction workers earn an average of $37 per hour and framers make $32 - up from $31 and $26 in 2019 and $26 and $20 in 2013.

Exhibit 23: Avg. annual construction job openings (thousands)
Construction job openings has been elevated since 2020



Source: U.S. Bureau of Labor Statistics
Note: Seasonally adjusted

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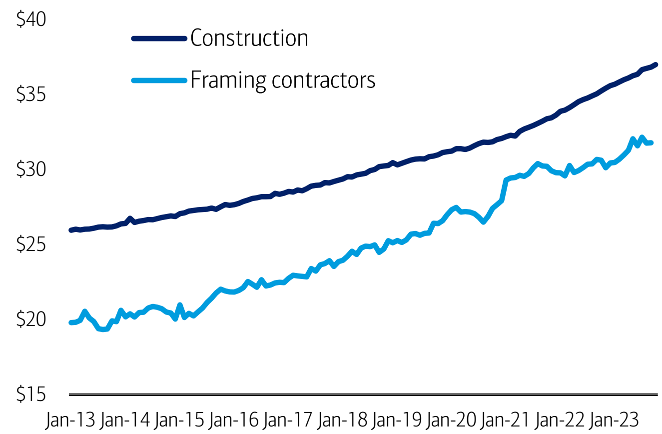
Exhibit 24: Avg. hourly earnings for construction workers and framing contractors
Wages have increased 4-5% annually since 2019



Source: U.S. Bureau of Labor Statistics
Note: Seasonally adjusted. Data through Oct 2023

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Brief history and description

History

Smith Douglas Homes was founded by Executive Chairman Thomas Bradbury in 2008 and broke ground on its first home in Atlanta, Georgia. In 2014, the company surpassed 500 cumulative closings in Atlanta and began to establish its regional presence with organic expansion into the Raleigh market followed by Birmingham in 2016, and Charlotte and Nashville in 2017.

In 2020, Smith Douglas completed over 900 annual home closings in Atlanta while also closing on over 200 homes in each of their other markets. The company continued its organic expansion and entered the Huntsville market in 2020. In 2022, Atlanta was the first market to account for over 1.0k home closings in a calendar year for the company. Overall, Smith Douglas closed on 2.2k homes across all their markets and surpassed 10k cumulative home closings. In 2023, Smith Douglas was ranked the second-largest private builder by 2022 closings by the Atlanta Real Estate Forum.

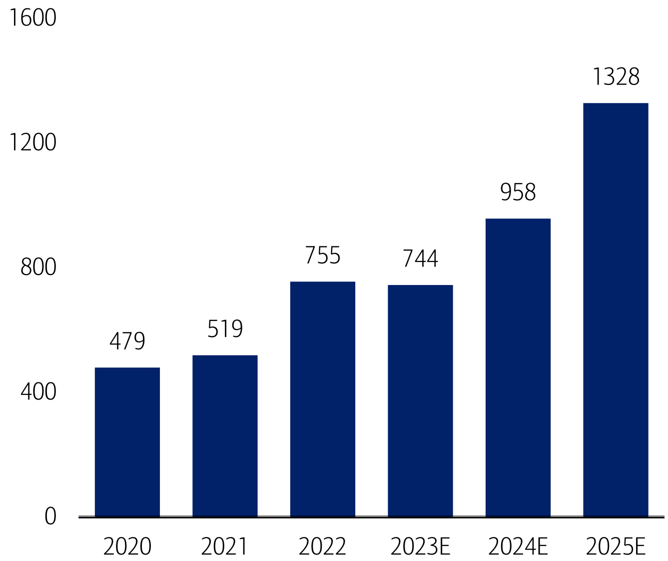
In July 2023, Smith Douglas Homes acquired Devon Street Homes, a Houston-based regional homebuilder to create a launching point for the company in the Texas market. Devon Street Homes closed 324 homes in 2022. Smith Douglas Homes is focused on the next phase of growth by expanding operations within the Southern United States.

In September 2023, Smith Douglas Homes announced an Initial Public Offering. The company was listed the NYSE in January 2024, when it was priced at $21 per share and raised $161.54mm. Today, Smith Douglas serves homebuyers in 7 metropolitan areas in 5 states including Alabama, Georgia, North Carolina, Tennessee, and Texas.

Company description

Smith Douglas is a Southeast-focused, homebuilder focused on the entry-level market with an average selling price of $343K for closings in 2022. SDHC delivered around 2,200 homes in 2022 for $755mm in revenue. In that year it ranked 38th on the Builder 100 and as the 20th largest private builder in the U.S. SDHC started in 2008 in the Atlanta area and has expanded to seven markets across the Southeast and Texas. Currently, Smith Douglas is the 6th-largest builder in Atlanta (4% share) and 10th-largest builder in Nashville (3% share). The company has roughly 12,000 lots under control, primarily through option contracts.

Exhibit 25: SDHC annual revenue ($M)
We expect revenue to growth to accelerate in 2024 and 2025



Source: BofA Global Research estimates, company filings

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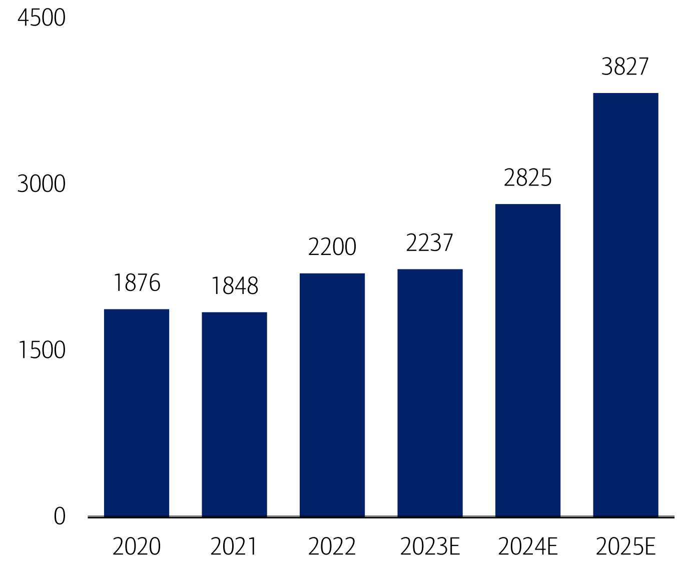
Exhibit 26: SDHC home closings
Closings are expected to accelerate in 2024/2025



Source: BofA Global Research estimates, company filings

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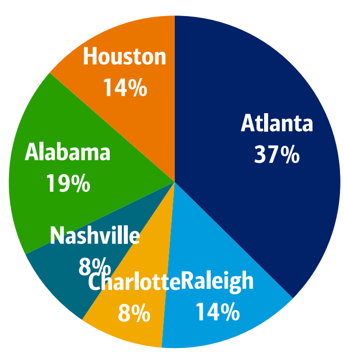
Operating markets

SDHC operates in seven markets: Atlanta (GA), Birmingham (AL), Charlotte (NC), Raleigh (NC), Houston (TX), Huntsville (AL) and Nashville (TN).

Exhibit 27: Closings by market (2024E)
We expect Atlanta to continue to be largest market for SDHC



Source: BofA Global Research estimates

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Management team

Thomas L. Bradbury, Executive Chairman and Director

Thomas L. Bradbury is the founder of Smith Douglas and has served as a member of the board of directors since its formation and as the Chairman of Smith Douglas' board of managers since 2016. He previously served as the Chief Executive Officer from inception until 2019. Bradbury previously founded Colony Homes in 1975, which was sold to KB Home in 2003.

Gregory S. Bennett, President, Chief Executive Officer, Vice Chairman, and Director

Gregory S. Bennett has served as the Chief Executive Officer and President of Smith Douglas since 2019 and as a member of the board of directors since its formation. Prior to that, he served as the Chief Operating Officer since 2015. Greg Bennett was previously an Executive Vice President at KB Home where he ran the Southeast division. Prior to that, he was the Atlantic region president for Colony Homes, which he joined in 1986.

Russell Devendorf, Executive Vice President, and Chief Financial Officer

Russell Devendorf has served as the Chief Financial Officer and Executive Vice President of Smith Douglas since 2017. Devendorf was previously served as Chief Financial Office and Senior Vice President at WCI Communities from 2008 to 2017. Prior to the, he was a Vice President- Finance at Meritage Homes. He is a Certified Public Accountant and a Certified Treasury Professional.

Income statement

Exhibit 28: We expect strong earnings growth for Smith Douglas driven by higher revenue
Smith Douglas income statement ($ mms, except per share data)

YE 12/31	2021	2022	2023E	2024E	2025E
Revenue					
Total Revenue	**$518.9**	**$755.4**	**$744.5**	**$957.8**	**$1,328.3**
Cost of Goods Sold					
Cost of house sold	393.9	529.8	534.0	708.8	994.1
COGS - interest expense	2.1	2.8	2.2	1.3	0.3
Total Cost of Goods Sold	**$395.9**	**$532.6**	**$536.2**	**$710.0**	**$994.4**
Gross Profit					
Home closing gross profit	$122.9	$222.8	$208.3	$247.8	$333.9
Selling General & Administrative Expenses					
SG&A	$63.2	$82.4	$90.1	$119.6	$155.0
Depreciation	1.0	0.9	$1.2	$1.2	$1.3
Operating Income					
Total Operating income	**$58.7**	**$139.5**	**$117.0**	**$127.0**	**$177.6**
Other					
Interest Expense	$1.7	$0.7	$1.1	$0.4	$0.4
Equity in income from unconsolidated entities	(0.6)	(1.1)	(0.9)	(1.5)	(3.0)
Other (income) loss, net	0.2	(0.6)	(0.2)	-	-
Forgiveness of PPP loan	(5.1)	-	-	-	-
Total other (income)/expense	**($3.8)**	**($1.0)**	**$0.0**	**($1.1)**	**($2.6)**
Income before provision for income taxes	**$62.5**	**$140.4**	**$117.0**	**$128.1**	**$180.2**
Provision for Income Taxes	$0.0	$0.0	$0.0	$4.8	$6.8
Net Income	**$62.5**	**$140.4**	**$117.0**	**$123.3**	**$173.4**
Net earnings attributable to non-controlling interest	$62.5	$140.4	$113.5	$108.9	$153.2
Net Income attributable to Smith Douglas Homes Corp	**$0.0**	**$0.0**	**$3.5**	**$14.4**	**$20.3**
Provision for Income Taxes (adjusted)	$15.6	$35.1	$29.2	$32.0	$45.1
Net Income (adjusted)	**$46.9**	**$105.3**	**$87.7**	**$96.1**	**$135.2**
Diluted EPS (GAAP)		$3.13	$2.61	$2.34	$3.28
Cash EPS (estimate using 33% tax rate)		$1.47	$1.42	$1.63	$2.28
Diluted EPS (Adjusted Shares, Cont. Ops.)		**$2.35**	**$1.96**	**$1.82**	**$2.55**
Adjusted Common Shares Outstanding:					
Diluted	**44.9**	**44.9**	**44.9**	**52.7**	**52.9**

Source: Company filings, BofA Global Research estimates

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Exhibit 29: We forecast 26% delivery growth
Smith Douglas delivery, order and backlog outlook

YE 12/31	2021	2022	2023E	2024E	2025E
Homes Delivered					
Number of Homes	**1,848**	**2,200**	**2,237**	**2,825**	**3,827**
Y/Y Change	(1.5%)	19.0%	1.7%	26.3%	35.5%

Exhibit 29: We forecast 26% delivery growth
Smith Douglas delivery, order and backlog outlook

YE 12/31	2021	2022	2023E	2024E	2025E
Dollars	**$518.9**	**$755.4**	**$744.5**	**$957.8**	**$1,328.3**
Y/Y Change	8.2%	45.6%	(1.4%)	28.7%	38.7%
Average Price	**$280.8**	**$343.3**	**$332.8**	**$339.0**	**$347.1**
Y/Y Change	9.9%	22.3%	(3.1%)	1.9%	2.4%
Net Orders					
Number of Homes	**1,920**	**1,928**	**2,357**	**2,996**	**4,116**
Y/Y Change	(21.0%)	0.4%	22.3%	27.1%	37.4%
Backlog					
Number of Homes	**1,043**	**771**	**961**	**1,132**	**1,421**
Y/Y Change	7.4%	(26.1%)	24.6%	17.8%	25.5%
Conversion Ratio (Units)	54.0%	53.4%	55.9%	72.0%	79.3%

Source: Company filings, BofA Global Research estimates

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Price objective basis & risk

Smith Douglas Homes Corp. (SDHC)
Our $28 PO is based on 3.4x price to tangible book (implies 15x 2024E P/E), a significant premium to peers, which is justified by Smith Douglas's higher return on equity profile and growth outlook. We are constructive on SDHC's asset-light model and growth but expect ROE to decline near-term (albeit off an exceptionally high level) as it integrates Devon Street and gains scale in its new markets.

Downside risks: (1) worse-than-expected demand in core markets, (2) a decline in finished lot availability, leading to gross margin pressure and declining return on equity, (3) an increase in interest rates leading to affordability challenges, (4) significant increase in land, labor or material costs, (5) slowing US economic growth.

Upside risks: (1) better-than-expected demand in core markets, (2) an increased in finished lot availability, leading to gross margin acceleration and an increasing return on equity, (3) pullback in interest rates, key input costs or home price appreciation.

Analyst Certification

I, Rafe Jadrosich, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Homebuilders and Building Products Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Armstrong World Industries, Inc.	AWI	AWI US	Rafe Jadrosich
	Builders FirstSource Inc	BLDR	BLDR US	Rafe Jadrosich
	D.R. Horton, Inc.	DHI	DHI US	Rafe Jadrosich
	Latham Group, Inc.	SWIM	SWIM US	Shaun Calnan, CFA
	Leslie's	LESL	LESL US	Shaun Calnan, CFA
	NVR, Inc.	NVR	NVR US	Rafe Jadrosich
	Owens Corning	OC	OC US	Rafe Jadrosich
	PulteGroup Inc.	PHM	PHM US	Rafe Jadrosich
	The AZEK Company Inc.	AZEK	AZEK US	Rafe Jadrosich
	Toll Brothers, Inc.	TOL	TOL US	Rafe Jadrosich
	TopBuild Corp	BLD	BLD US	Rafe Jadrosich
	Trex Company, Inc.	TREX	TREX US	Rafe Jadrosich
NEUTRAL				
	Dream Finders Homes, Inc.	DFH	DFH US	Rafe Jadrosich
	KB Home	KBH	KBH US	Rafe Jadrosich
	Lennar Corporation	LEN	LEN US	Rafe Jadrosich
	Smith Douglas Homes Corp.	SDHC	SDHC US	Rafe Jadrosich
UNDERPERFORM				
	Fortune Brands Innovations Inc	FBIN	FBIN US	Rafe Jadrosich
	Hayward Holdings, Inc.	HAYW	HAYW US	Rafe Jadrosich
	Masco Corp	MAS	MAS US	Rafe Jadrosich
	Mohawk Industries	MHK	MHK US	Rafe Jadrosich
	Patrick Industries, Inc.	PATK	PATK US	Rafe Jadrosich
	Pool Corporation	POOL	POOL US	Shaun Calnan, CFA

*iQ*method℠ Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings	**Numerator**	**Denominator**
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	**Numerator**	**Denominator**
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Disclosures

Important Disclosures

Equity Investment Rating Distribution: Building Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	39	44.83%	Buy	22	56.41%
Hold	18	20.69%	Hold	11	61.11%
Sell	30	34.48%	Sell	8	26.67%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. *Coverage Cluster* is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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The issuer is or was, within the last 12 months, an investment banking client of BofAS and/or one or more of its affiliates: Smith Douglas Homes.
BofAS or an affiliate has received compensation for investment banking services from this issuer within the past 12 months: Smith Douglas Homes.
BofAS or an affiliate expects to receive or intends to seek compensation for investment banking services from this issuer or an affiliate of the issuer within the next three months: Smith Douglas Homes.
BofAS or one of its affiliates is willing to sell to, or buy from, clients the common equity of the issuer on a principal basis: Smith Douglas Homes.
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