

# Big Builders Getting Bigger

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Within the next five to seven years, a single "mega-builder" will cross the 100,000-unit-a-year threshold, believes a financial consultant who has helped create many of the nation's largest home building firms.

But that company -- and other giants like it -- are not likely to reach six-figure territory by growing from within, Michael Kahn of Michael P. Kahn & Associates in Ponte Vedra Beach, Fla., said at the National Association of Home Builders' annual convention in Orlando last month.

"It's very difficult to grow that large organically," said Kahn, who has a hand in arranging more than half the 150 mergers that have taken place among builders over the past 15 years.

The nation's largest builder, currently D.R. Horton, built just under 45,000 houses in 2004, according to the NAHB's figures, so it has a long way to go hit the hundred grand mark.

But there is no doubt that the big builder giants like Horton, Pulte, Lennar, Centex and KB, to name the top five, are controlling a larger and larger share of the market. In 2004, the last year for which full year numbers are available, the ten largest were responsible for 20 percent of all sales, according to the NAHB. And the top 100 accounted for nearly 40 percent.

A 2002 study by Anderson Corp. Finance predicted that the nation's 20 largest builders will account for 75 percent of all sales by 2011. But Gopal Ahluwalia, the builder group's staff vice president for research, doubted that will be the case, or that one company will produce 100,000 houses in a year's time.

At the same time, though, he expects national builders to continue to acquire "sizeable" local and regional competitors.

It's possible a one builder -- or a multi-divisional company building under a single flag -- could erect 100,000 houses, but only if two of one of the top five builders acquires another top five company, Ahluwalia said.

What's more likely, he said, is that within the next three years, the largest builders in the land will be building at a an annual rate of 50,000 units or more.

Although the penchant to acquire rivals started began in the early 1990s in the building business, merger mania was a late starter compared to other industries, according to Kahn. But it has continued unabated.

During the first 10 months of 2004 alone, 18 deals were completed representing 12,000 houses and some 2,000 employees, according Kahn's firm. By contrast, there were only 17 acquisitions in all of 2004.

Last year's largest deals included Hovnanian Enterprises' acquisition of Town & Country Homes, which builds 2,000 houses a year in the Chicago area, and First Homebuilders of Florida, a Cape Coral-based company which had 1,800 closing in 2004. Another big transaction involved TOUSA's acquisition of another Cape Coral firm, Transeastern Properties, which built 2,300 houses in 2004.

Builders tend to buy up their competitors for several reasons. For one thing, it's easier to buy your way big than grow your way big. For another, it's easier to buy an operating entity when entering a new market than it is to start up fresh. But for the most part, it's the only way to quench the insatiable appetite for land.

While a Top Builder typically has six years worth of land in inventory, NAHB's Ahluwalia reported, Toll Brothers has more than nine years worth at the firm's current sales pace and Pulte has 8.9 years worth.

Pulte alone has 369,000 lots under its control, either owned outright or under option; Horton, 323,000; Lennar, 303,000, and Centex, 286,000, according to the NAHB.

Since 1993, Lennar has acquired 23 other companies, while Horton has nabbed 17 and KB has taken 14.

Surprisingly, perhaps, acquired companies rarely spurn their suitors, according to Kahn. Indeed, in seven out of every 10 deals the financial consultant has worked on, the seller initiated contact.

When his client is the buyer, the company is "very focused on what it is looking for" in the way of an acquisition. "They typically identify three to five builders in the marketplace they want," Kahn said, adding that he has "never missed" when it comes to locating a acquiescent seller.

"I always find someone willing to sell," he said.

Despite the penchant for merger, and the advantages that size gives big builders over the competition -- their cost of capital is lower, they obtain volume discounts from suppliers and they enjoy production efficiencies that others cannot match -- Ahluwalia doesn't think the days of small and mid-size builders are numbered.

"Small and medium volume builders will continue to concentrate on niche markets," he told reporters. "The overall market will continue to include a very large number of small companies."

However, according to a report by Harvard University's Joint Center for Housing Studies that was released at the convention, the top five builders have more than a 45 percent market share in Denver and Austin, and better than a 35 percent market share in Sacramento, Las Vegas and Ft. Myers, Fla.