S&P Global Ratings

Research

Research Update:

Taylor Morrison Home Corp. Upgraded To 'BB', Outlook Stable; Note Rating Also Raised

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Overview

- Phoenix-based homebuilder Taylor Morrison Home Corp. (TMHC) announced that its private equity sponsors divested the remaining interest in the company and will no longer hold any seats on its board of directors.
- With the change in ownership, we now view a leveraging event as less likely, and we expect the company to maintain its improved leverage profile on a sustained basis.
- We are raising our corporate credit rating on TMHC to 'BB' from 'BB-'. The outlook is stable. In conjunction, we are also raising the issue-level rating on the company's senior secured notes to 'BB' from 'BB-'. The recovery rating is '3'
- The stable outlook reflects our expectation that the currently favorable new home demand environment will support its organic growth plan and still maintain leverage comfortably below 4x EBITDA.

Rating Action

On Jan. 22, 2018, S&P Global Ratings raised its corporate credit rating on Taylor Morrison Home Corp. to 'BB' from 'BB-'. The outlook is stable.

In addition, we raised the issue-level rating on TMHC's senior unsecured debt to 'BB' from 'BB-', in line with the corporate credit rating. The '3' recovery rating on the notes indicates our expectation for meaningful (50%-70%; rounded estimate: 65%) recovery to noteholders in the event of a default.

Rationale

The upgrade of TMHC to 'BB' reflects the sale of the controlling interests of its financial sponsors. Private equity sponsors Oaktree Capital Management, L.P. and TPG Global LLC have sold down all common shares and will relinquish their board seats; therefore, we no longer consider the company as sponsor-owned. The divestiture has lead to a more favorable view of the company's financial policy. In addition, we view a material leveraging event as unlikely and believe that the company would not increase leverage above 4x EBITDA without a clear, achievable path back to 3x-4x. We expect that the company will maintain its current leverage at between 2x and 3x EBITDA and debt to capital of 30%-40% in 2018.

Our opinion of TMHC's business risk incorporates its favorable market share within some of its local markets and profitability measures that have been close to the median of rated peers and have remained stable over the past few years. This is balanced by lower unit volume and a narrow geographic platform relative to larger rated peers. Furthermore, our assessment of TMHC's business risk also incorporates the significant cycle risk and capital intensive nature of the homebuilding industry which we observed in 2008-2010.

TMHC was the U.S.'s seventh-largest homebuilder by home deliveries for the 12 months ended Sept. 30, 2017, just ahead of Meritage Homes Corp. (BB/Stable/--). We believe the company to be within the three largest builders in Phoenix, and to have top 10 positions in 12 other major markets (among the 50 largest U.S. housing markets). Overall, the company's platform covers eight states and 17 markets; its largest concentration communities lies in its East segment, with 44% of all active communities as of Sept. 30, 2017. However, due to higher average sales prices (ASPs), the company's West segment is slightly larger by homebuilding revenue contributing 36%. We view this level of diversity as appropriate for the rating but as somewhat concentrated compared with larger peers. These operating dynamics in concert have allowed the company to maintained stable EBITDA margins of 12%-13% (and adjusted gross homebuilding margins of roughly 21%), ranking it close to the median of rated peers and on par with our forecast. Return on capital has been 11%-12% over the past year, also ranking near the peer median, which we expect it to maintain.

We assess the company's financial risks incorporating our view that the company's financial policy is no longer driven by the controlling financial sponsor owners. We expect the company to maintain the more conservative credit metrics it has achieved on a sustained basis. On Jan. 11, 2018, TMHC announced that Oaktree Capital and TPG Capital sold the remainder of their common equity interest in the company and will no longer hold seats on its board of directors.

Our base case forecast incorporates the following underlying assumptions:

- S&P Global economists' view of U.S. GDP growth of 2.8% in 2018, slowing to 2.2% in 2019.
- Our general view that demand for new homes in the U.S. will remain healthy and will outstrip supply, with favorable conditions for builders in TMHC's core markets of California and Texas.
- We assume continuing home closing growth in the mid-single digits and average sales prices (ASP) continuing to climb, albeit at a slower rate, will result in homebuilding revenue of $4.1 billion-$4.2 billion in 2018 and $4.4 billion-$4.5 billion in 2019.
- We also assume that adjusted gross homebuilding margins (excluding capitalized interest from cost of sales) will be 20%-21%, contracting slightly from 2017 levels as cost increases outweigh ASP growth, and that sales, general, and administrative costs will equate to roughly 10% of total revenues.
- Our base case does not assume any dividends or share repurchase activity over the next 12 months.

Given the assumptions above, we forecast debt to EBITDA between 2x and 3x, debt to capital improving toward 30%; we view these levels as strong for the rating. We also forecast EBITDA interest coverage in the 5x-6x range, which is in line with the rating.

Liquidity

We view TMHC's liquidity as strong based on the following factors:

- Cash sources will outweigh uses by at least 1.5x over the next 12 months.
- Sources would continue to exceed uses and covenants would not be breached if EBITDA were 50% below our forecast.
- Our view that the company's cash position and largely unused revolving credit facility would allow it to withstand a high-impact, low-probability event without the need for refinancing.
- Our view of a sound relationship with banks, supported by its long tenure ability to extend it credit facilities with its bank group.
- Our expectation that the company will managing liquidity at similar levels on a consistent basis.

Primary cash sources and uses considered in our liquidity calculation include the following:

- Approximately $265 million cash on hand as of Sept. 30, 2017.
- Full availability of its $500 million revolving credit facility, due in April 2019 (less outstanding letters of credit).
- Our forecast of generated funds from operations of roughly $285 million-$300 million over the next 12 months.
- Seasonal peak working capital deficit commensurate with levels observed over the past two years; this includes spending for land acquisition and development.
- No debt maturities in 2018.

Outlook

The stable outlook reflects our expectation for TMHC to continue to capitalize on the U.S. housing recovery and favorable demand environment to spur growth in new home sales and strengthen its market share, while maintaining strong leverage measures in the area of 2x-3x debt to EBTIDA and 30%-40% debt to capital.

Upside scenario

Despite our view of improving credit measures over the next year, we view an upgrade as unlikely due to the fact that the company's higher-rated 'BB+' homebuilding peers (such as Lennar Corp., PulteGroup Inc., and Toll Brothers Inc.) exhibit greater size, scale, and geographic diversity. However if leverage improves faster than our forecast predicts to below 2x debt to EBITDA over the next 12 months, the stronger leverage profile would help to mitigate difference in size and market share such that we may consider a one notch upgrade.

Downside scenario

With strong leverage measures for the current rating providing some cushion, we view a downgrade over the next 12 months as less likely. However, we may consider a downgrade if the company pursues more aggressive growth plans or returns to shareholders, pushing leverage over 4x EBITDA or debt to capital to 45% on a sustained basis.

Ratings Score Snapshot

Corporate Credit Rating
BB/Stable/--

Business risk: Fair
- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Issue Ratings

Our recovery rating on the company's senior unsecured notes is unchanged at '3'. Corresponding to this recovery rating, the issue-level rating will move up one notch to 'BB' from 'BB-', remaining in line with the corporate credit rating. For more detail on our recovery rating, please see our most-recent summary analysis for the company, published March 22, 2017.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria - Corporates - Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Taylor Morrison Home Corp		
TMM Holdings Limited Partnership		
Corporate Credit Rating	BB/Stable/--	BB-/Stable/--

Issue-level Ratings Raised; Recovery Ratings Unchanged

	To	From
Taylor Morrison Communities Inc.		
Taylor Morrison Holdings II, Inc.		
Senior Unsecured	BB	BB-
Recovery Rating	3(65%)	3(65%)
Taylor Morrison Communities Inc.		
Senior Unsecured	BB	BB-
Recovery Rating	3(65%)	3(65%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.