2007

Reggie Middleton's Boom, Bust & Bling Blog – www.reggiemiddleton.typepad.com

[REGGIE MIDDLETON'S BOOM, BUST, & BLING BLOG RYLAND GROUP ANALYSIS UPDATE]

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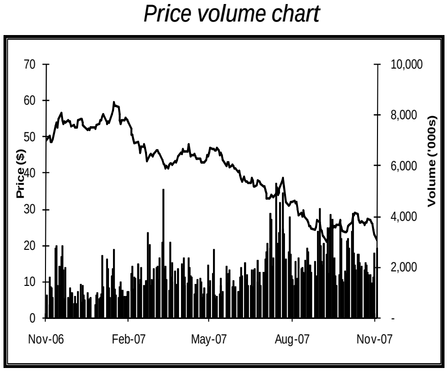
November 29, 2007

Price (US$) :	21.1
52 Week range (US$) :	19.97 - 60.13
Shares Outstanding (mn):	42.1
Shareholder's equity (US$ mn) :	1,511
Market Cap (US$ mn) :	887
EV (US$ mn) :	1,929
WACC:	15.3%
Beta:	1.76
Debt to Equity:	43.6%

Price performance (%)	1 m	3 m	12 m
Absolute	-16.6%	-24.7%	-57.4%
Relative to SPX	-9.8%	-23.6%	-59.7%

	2006	2007	2008
Revenues ($ mn)	4,757	2,882	2,671
EBITDA ($ mn)	567	(294)	(397)
EPS $	7.8	(4.4)	(6.2)
EV/ EBITDA	3.4	NM	NM
Debt - Capital	*39%*	*44%*	*50%*
P/E	2.7	NM	NM
P/B	0.64	0.70	0.89
Z-Score	4.14	2.43	2.09

Price volume chart



Investment summary

As the US homebuilding companies tread through the current challenges surrounding the US residential housing sector, the latest financial results show a gloomy picture of the state of affairs. Like most of its peers, Ryland Group (Ryland) is facing continued pressure on its sale volumes and prices, with no near-term prospects of recovery in sight. In addition, in the midst of tightening lending standards off global liquidity crunch, its financial services business is expected to be impacted as margins are squeezed and the company's ability to sell mortgages to third party is tested. The resultant negative margins in the homebuilding and the fast declining margins in the financial services business are expected to result in a more difficult financial position for the company, with its 2008 and 2009 EPS projected to drop to negative $6.21 and $5.39 post an estimated negative $4.38 in 2007.

Key Highlights

Declining homebuilding margins: Ryland's homebuilding gross margins are expected to be under continued downward pressure amid declining home prices and sales volumes off deteriorating homebuilding sector in the United States. This coupled with rising inventory impairment charges and increased price concessions and sales incentives to foster sales has resulted in even a more difficult operating environment for Ryland. The company reported negative gross margins of 1.2% and 0.3% in 2Q2007 and 3Q2007, respectively, with the margins not expected to turn positive in the next couple of years. We expect full year 2007 gross margins to be 1.9%, and believe the downward trend would continue with the expected negative gross margins of 3.5% and 2.8% in 2008 and 2009, respectively.

Inventory impairment: As a result of declining home values, Ryland recorded an inventory valuation adjustment (downwards) of $128.1 million in 3Q2007, representing a negative earnings impact of $3.05 per share. In midst of declining home prices, the company is expected to book an inventory impairment charge of $438.5 million and $317.4 million for 2007 and 2008, respectively. However, we believe Ryland is strategically better placed vis-à-vis its peers with regard to inventory holdings in the worst hit markets in the United States. Owing to its strategy of geographical diversification as evident by the fact that not more than 10% of the company's capital is allocated to any single of the 28 markets it operates in, Ryland had limited exposure to the most disturbed housing markets. In the most overheated US markets, including California, Phoenix and Fort Meyers, Ryland had only 12.0%, 2.6% and 1.6% of its total assets as on June 30, 2007, respectively. As a result, Ryland's inventory impairment charge as a percentage of inventories for the 3QFY2007 was 5.4% against an average of 8.0% for its peer group. For the purpose of our analysis we have taken Ryland's peer group to include Lennar Corp, KB Home, Dr. Horton Inc, Pulte Homes Inc, Hovnanian Enterprises Inc, Beazer Home, MDC Holdings Inc and Sparkassen Immobilien.

Mounting troubles in Financial Services: Increasing interest costs on warehouse lines of credit off rising spreads resulting from tightening of lending standards, and growing difficulties in resale of mortgages in the secondary market pose a challenge for most US homebuilders offering mortgage financing to home buyers. Ryland's mortgage financing business has been impacted by the currently prevailing tough credit conditions with the company's mortgage origination capture rate falling to 77.7% in 3Q2007 from 82.2% in 3Q2006. The company's ability to sell majority of its mortgages under a no-recourse agreement to a third-party financing company has also been affected with its principal buyer, Countrywide Financing, running into financial troubles. Apart from compressed margins, this may translate into Ryland having to hold a larger proportion of its mortgages on its balance sheet, with all associated risks of defaults.

Limited exposure to JV liabilities: Ryland's total exposure towards debt through unconsolidated entities is among the lowest in the industry. As of September 30, 2007, Ryland participated in 11 joint ventures with about $30.4 million investments in unconsolidated entities and $41.7 million representing the company's share in the total joint venture debt. With relatively lower concern over hidden liabilities associated with the company, investors and creditors could place higher confidence under the present difficult housing scenario in the United States.

Higher cancellation rates: The recent quarters have witnessed cancellation rates of the homebuilding companies increased to a significant level, driven by tightening lending standards and persisting negative consumer sentiments. Ryland's 3Q2007 cancellation rate was 43.0%, up from 34.3% in 2Q2007. We expect this to increase further to average at 47.5% for 2007 and 39.9% for 2008. Faced with higher cancellation rates, Ryland faces the pressure of offering price discounts and incentives to dispose for cancelled housing units which could further strain the company's margins. The company has initiated efforts to reduce its inventory levels and is cutting down on its land holdings with its total land lots under control as of September 30, 2007 standing at 45,254, a 32.4% decline over the previous year. The company's owned lots (63% of the total lots) declined 14.2% y-o-y while its option lots (37% of the total lots) fell 50.4%.

Disappointing 3Q2007 results: Ryland's 3Q2007 revenues declined 35.2% to $732.3 million against $1,130.9 million in 3Q2006 off a 32.3% decline in deliveries to 2,495 units and a 2.7% decline in average sales price to $284,000. Including inventory valuation adjustments and write-offs of $128.1 million, Ryland reported negative gross margin of 0.3% versus gross margin of 22.5% in 3Q2006. Ryland net loss was $54.7 million or $1.30 per share against net earnings of $87.9 million or $1.97 per share in 3Q2006.

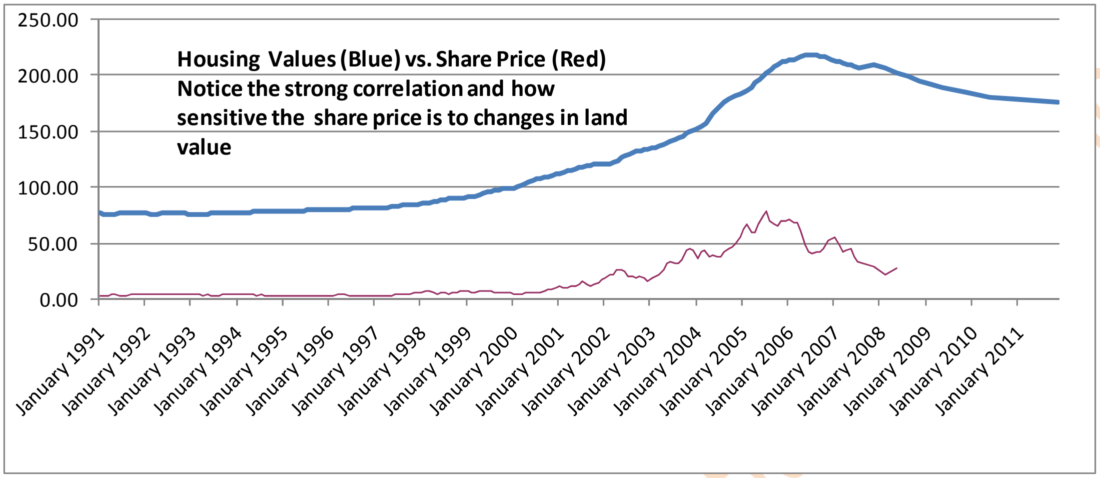
Possibility of downgraded credit ratings: Responding to concerns about the company's ability to reduce its inventory levels and generate positive cash flow, S&P changed its outlook for Ryland in November 2007 from stable to negative, rating the company at BBB-minus. Moody's has also announced it may downgrade its rating for Ryland's senior unsecured debt rating to junk from Baa currently.

Refinancing long-term debt with short-term debt: During 3Q2007, Ryland pre-paid $75 million of senior debt financing partly by drawing $42 million from its revolving credit facility. Of late Ryland has been aggressively utilizing its borrowings under revolving credit facility and has drawn down $63 million, $11 million and $42 million in 1Q2007, 2Q2007 and 3Q2007, respectively, bringing its aggregate borrowing under the revolving credit facility to $117 million (of its total borrowing limit of $750 million). As the company is scheduled to repay another long-term debt installment of $75 million in 2Q2008, we expect company's utilization under its revolving credit facility to increase to $217 million by the end of 2008. This refinancing would entail increased interest costs for Ryland as the company finds itself hard tied to repay its short-term credit line borrowings which carry higher costs vis-à-vis long-term finance. Further, as Ryland faces negative operating cash flow of $505.2 million in 2009, we expect the company to drawdown additionally under its credit line raising its total drawdown to $717 million by the end of 2009.

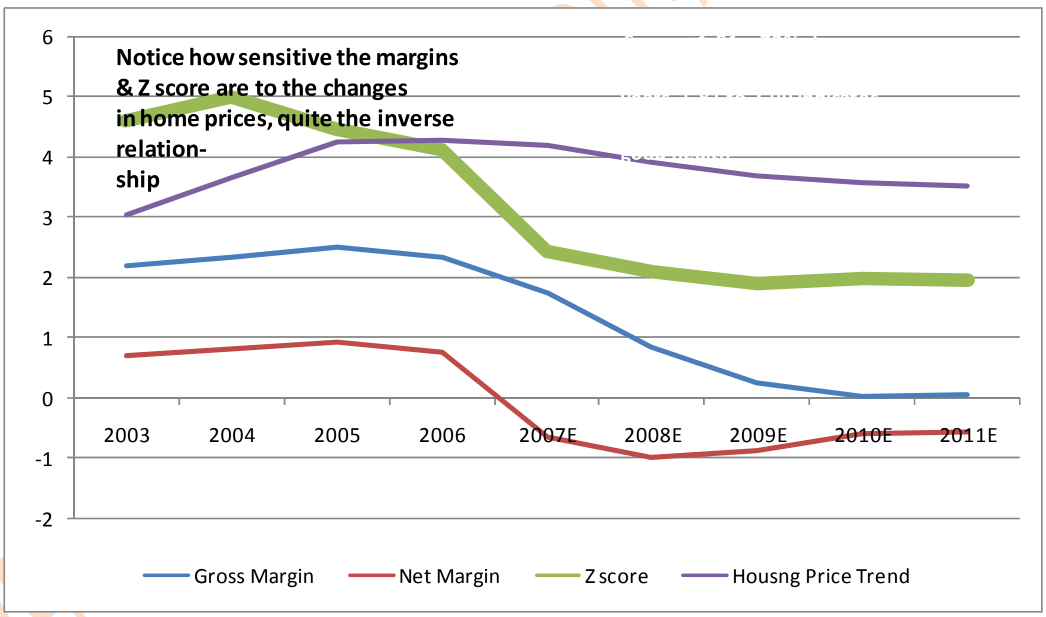
Increased cost of financing: In view of deteriorating financial condition of the company, we believe Ryland would not be able to uphold conditions set forth in its debt covenants starting 4Q2008 with a leverage ratio of 47.9% (against prescribed leverage ratio of 47.5%). As the company undertakes further borrowing under its revolving credit facility, Ryland's leverage ratio is expected to increase to 66.3% in 2009 (against prescribed limit of 37.5%), and to 85.0% and 93.3%, in 2011 and 2012, respectively. With increased use of short-term borrowing and widening gap between Ryland's leverage ratio and prescribed limits, we envisage increase in financing cost for Ryland. We expect Ryland's effective interest rate to increase from 4.4% in 2007 to 5.6% in 2008. For 2009, 2010 and 2011, we expect Ryland's effective interest rate to increase to 6.4%, 6.6% and 6.8%, respectively.

Negative management outlook: Since August 2007, insiders have been net sellers, selling approximately 0.49 million shares or 1.2% of outstanding shares worth $15.5 million, reflecting the management's reduced confidence on the company's prospects in the near term.

Ryland's share price vis-à-vis U.S housing index

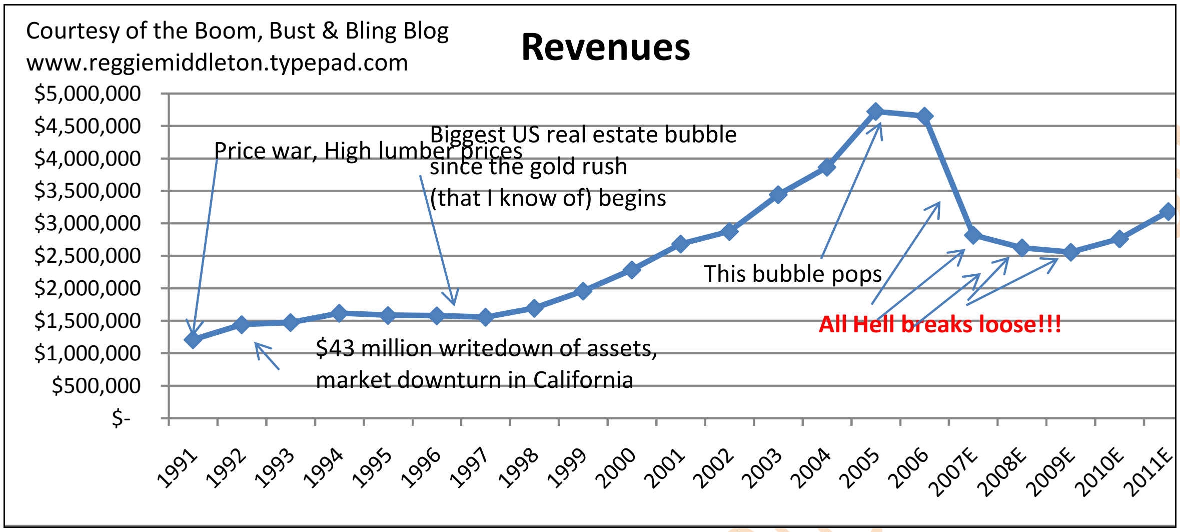


Impact of housing price on Ryland's solvency



Ryland's share price has shown a high degree of correlation with the US housing prices. The share price has immensely benefited during the boom in the US housing market driven by significant growth in housing prices. During January 2000-2007, Ryland's share price has yielded 1310.4% returns to its shareholders while housing prices increased 807% in the comparable period. However with the decline in home prices starting mid-2006 which is likely to continue into next few years, we envisage Ryland's share price to remain under pressure. According to S&P, Case Shiller Home Price Index is expected to decline 3.4% by May 2008, 9.7% by May 2009 and 13.5% by May 2010, over May 2007.

Driven by the declining trend in the US home prices, Ryland's gross margin declined from 25.1% in 2005 to 21.8% in 2006. We expect the company's margin to further deteriorate to 1.9% in 2007 and turn to a negative of 3.5% and 2.8% in 2008 and 2009, respectively.



Ryland's Z-score declined from a healthy 5.0 in 2004 to 4.14 in 2006. It further got worse-off to 2.89 as on September 30, 2007. We expect Ryland's Z-score to decline to 2.09 in 2008 and 1.89 in 2009, reflecting financial troubles and warning signals about potential bankruptcy, particularly in 2009 when the Z-score is very close to the danger zone of <1.81. From 2010, we expect Ryland's Z-score to improve to reach 1.96 and 1.95 in 2010 and 2011, respectively which is further expected to increase to 2.01 in 2012.

Ryland's homebuilding volumes

For new orders' estimates, we have used data pertaining to building permits from State of the Cities Data Systems (SOCDS), new housing starts and new home sales from US Census Bureau, and have identified key representative states/ cities in which Ryland operates.

Region	Source	Representative states/ cities
North	• SOCDS – Building permits	• Maryland, Delware, Ohio, Illionis, Indiana, Minnesota, Washington D.C.
	• US Census Bureau Housing starts and new home sales	• Midwest region
Southeast	• SOCDS – Building permits	• Florida, North Carolina, South Carolina and Georgia
	• US Census Bureau Housing starts and new home sales	• South region
West	• LAECD	• California
	• SOCDS – Building permits	• California, Nevada, Arizona and Colorado
	• US Census Bureau Housing starts and new home sales	• West Region
Texas	• SOCDS – Building permits	• Texas
	• US Census Bureau Housing starts and new home sales	• South region

The above sources have been assigned weights with higher weights assigned to SOCDS building permits data since it tracks the trend state-wise and reflects the expected new construction activity, in turn indicating the new orders received.

Region/ Year	New orders (Gross - y-o-y growth)					
	2007	2008	2009	2010	2011	2012
North	*-19.4%*	*-5.8%*	*5.8%*	*11.7%*	*17.5%*	*26.3%*
Southeast	*-12.4%*	*-3.7%*	*3.7%*	*11.2%*	*22.4%*	*22.4%*
Texas	*2.9%*	*2.1%*	*3.1%*	*3.4%*	*6.8%*	*8.1%*
West	*-20.7%*	*-7.1%*	*4.5%*	*10.5%*	*18.3%*	*29.1%*
Total	*-11.7%*	*-3.0%*	*4.1%*	*8.8%*	*16.0%*	*20.5%*

We expect Ryland's West region to experience the steepest decline in gross new orders followed by Southeast and North region. Overall, we expect Ryland's new orders to decline by approximately 11.7% and 3.0% in 2007 and 2008, respectively. However from 2009 onwards, we expect new orders growth to pickup in all the regions with an expected growth of 4.1% and 8.8% in 2009 and 2010, respectively.

Ryland's homebuilding price

To forecast average price for building, we have used key US home prices indices - Home Price Index (HPI) sourced from Office of Federal Housing Enterprise Oversight (OFHEO), S&P/Case-Shiller Home Price Index reported by Standard and Poor's (S&P), home asking prices from Housing Tracker and condor prices from Radar Logic. For each region, we have compiled available data from representative states/ cities listed below:

Region	Source	Representative states/ cities
North	OFHEO	Illinois, Washington,
	S&P	Chicago, Washington
	Housing tracker	Chicago, Washington
	Radar Logic	Chicago, Washington
Southeast	OFHEO	Florida
	S&P	Tampa, Miami
	Housing tracker	Tampa
	Radar Logic	Miami
Texas	OFHEO	Texas
	S&P	Dallas
	Housing tracker	Dallas, San Antonio
West	OFHEO	California, Nevada
	S&P	Las Vegas
	Housing tracker	Las Vegas, Los Angeles, Sacramento
	Radar Logic	Las Vegas

The above sources have been assigned weights to forecast pricing growth at each of Ryland's operating regions. To project pricing movement for the projected periods, we have used forecasted indices for the S&P/Case-Shiller Home Price Index. In addition, we have used historical spread of S&P/Case-Shiller Index with Housing tracker and Radar Logic to project pricing movements for Housing tracker and Radar Logic. Currently, we have assigned higher weight to S&P/Case-Shiller Home Price Index since it provides forecasted values for the projected period.

Region/ Year	Pricing growth (y-o-y growth)					
	2007	2008	2009	2010	2011	2012
North	-8.8%	-3.1%	-3.1%	0.4%	0.8%	3.3%
Southeast	-6.8%	-9.1%	-7.1%	-2.3%	2.3%	2.7%
Texas	-3.1%	-4.9%	0.6%	1.7%	1.9%	1.5%
West	-10.2%	-9.6%	-7.3%	-1.4%	1.7%	2.0%
Total	-2.1%	-8.4%	-5.3%	-0.5%	1.5%	3.0%

Housing price in the United States continue to deteriorate owing to excess supply as there is a significant push to reduce standing inventory across the homebuilding industry. Homebuilders are re-pricing their existing inventory to dispose of their complete units and cancelled order backlogs. Excess supply coupled with falling housing demand is exerting a downward pressure on home pricing. We expect average home price to decline 2.1% and 8.4% in 2007 and 2008, respectively, with downward trend continuing till 2010. We expect home prices to increase 1.5% and 3.0% in 2011 and 2012.

Ryland's Homebuilding revenues

Region/ Year	Homebuilding revenues (y-o-y growth)					
	2007	2008	2009	2010	2011	2012
North	-29.4%	-13.8%	3.0%	5.3%	11.1%	23.3%
Southeast	-42.1%	-9.8%	-8.0%	8.6%	13.0%	8.9%
Texas	-17.9%	-0.2%	4.2%	9.7%	18.1%	10.5%
West	-57.7%	1.5%	-9.2%	9.2%	21.5%	11.2%
Total	-39.4%	-7.0%	-2.5%	8.0%	15.3%	13.7%

We expect Ryland's homebuilding revenues to witness a decline of 39.4% and 7% in 2007 and 2008, respectively, to reach $9.49 billion and $6.37 billion in 2007 and 2008. We expect the trend to continue into 2009 expecting a decline of 2.5%. From 2010 the company's homebuilding revenues may pick-up with an expected growth of 8.0%, 15.3% and 13.7% in 2010, 2011 and 2012, respectively.

Ryland's Homebuilding cost of sales

Region/ Year	Per unit cost of sales - excluding impairment (y-o-y growth)					
	2007	2008	2009	2010	2011	2012
North	4.0%	1.8%	0.4%	2.8%	1.8%	1.1%
Southeast	8.6%	2.2%	1.9%	1.7%	1.2%	1.5%
Texas	9.8%	2.4%	1.3%	1.2%	1.1%	1.1%
West	2.0%	0.1%	0.9%	1.5%	1.1%	1.2%
Total	3.0%	1.5%	0.7%	1.9%	1.3%	1.5%

Region/ Year	Gross Margins (Including impairment)					
	2007	2008	2009	2010	2011	2012
North	13.2%	9.3%	9.6%	9.5%	8.6%	10.6%
Southeast	10.3%	-4.9%	-4.5%	-3.8%	-2.7%	-1.5%
Texas	16.9%	8.5%	5.0%	5.4%	6.1%	6.5%
West	-46.7%	-31.9%	-28.7%	-13.4%	-12.7%	-11.8%
Total	1.9%	-3.5%	-2.8%	0.3%	0.5%	2.0%

Ryland's unit cost of sales increased 8.1% and 9.1% in 2005 and 2006. However owing to cost cutting measures undertaken by the company, we expect Ryland's per unit cost of sales excluding impairment to stabilize with a nominal growth of 3.0% and 1.5%, in 2007 and 2008, respectively. Ryland's total cost of sales excluding impairment is expected to decline 34.7% y-o-y off a 36.6% decrease in deliveries in 2007.

However including an expected impairment charge of $438.5 million, total cost of sales would decline 24.0% in 2007. Going forward, the company's unit cost of sales excluding impairment is expected to increase 0.7% and 1.9% in 2009 and 2010, respectively.

Ryland's gross margins have declined continuously for the past seven quarters starting 1QFY2006 and have turned negative in the last 2 quarters. We expect Ryland to report a positive gross margin of 1.9% in 2007. However we expect the company's margin to turn a negative of 3.5% and 2.8% in 2008 and 2009, respectively. We believe that strong geographic distribution along with the company's resistance to offer incentives unlike other homebuilders will help Ryland to turnaround relatively faster compared with its peers. We expect Ryland to report positive margins of 0.3% and 0.5% in 2010 and 2011, respectively which is expected to increase to 2.0% in 2012.

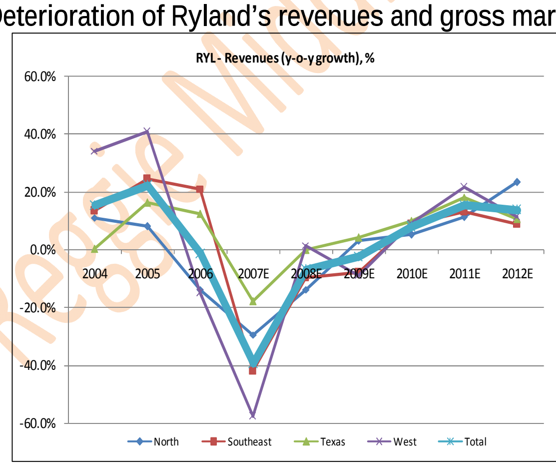
Ryland Financial service revenues

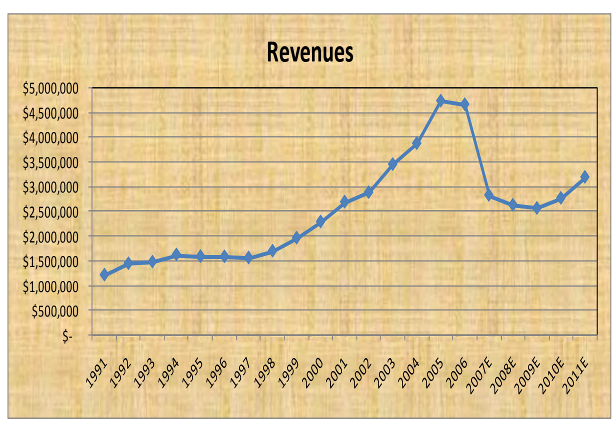
In addition to increasing interest liabilities on warehouse lines of credit increase, growing disability to re-sell the mortgages in the secondary market is posing a challenge for most homebuilders in the US who offer mortgage financing to its buyers. This should have an adverse impact on Ryland's financial services earnings as well as on its loan originations.

Region/ Year	Financial services					
	2007	2008	2009	2010	2011	2012
Revenues	61.0	46.3	42.9	46.6	56.2	68.1
- y-o-y (% growth)	*-20.3%*	*-30.2%*	*-7.2%*	*8.6%*	*20.6%*	*21.2%*
Pre-tax net earnings	32.7	26.5	24.6	26.7	32.2	39.0
Originations	7,250.9	6,742.4	6,566.7	6,914.9	8,011.9	9,290.5
Ryland's Homes origination capture rate	*74.3%*	*68.0%*	*64.3%*	*62.4%*	*63.6%*	*66.8%*

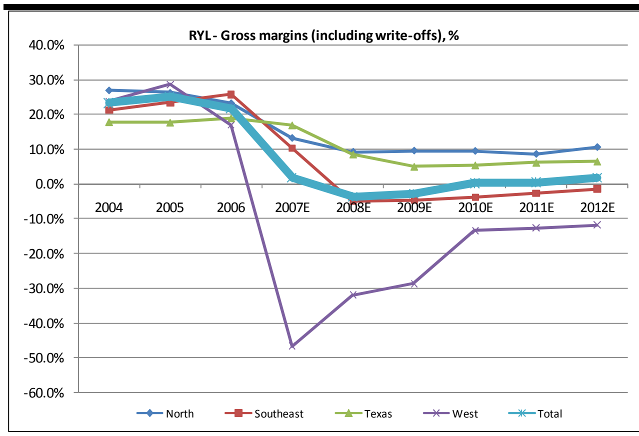
During 2006, Ryland originated 11,744 mortgage loans of approximately $3,464 million. Substantially all of the loans the Financial Services segment originates are sold in the secondary mortgage market under a no-recourse agreement. We believe that difficult conditions in the credit market would impact Ryland's capture rate which we expect to decline to 74.3% in 2007 and 68.0% in 2008, compared with 81.9% in 2006. In addition, the falling proportion of Alt-A loans which formed only 2% of all of Ryland's mortgages in 3Q2007 against 10% in 2Q2007 and 22% in 1Q2007, would result in lower mortgage originations. This along with bankruptcy prospects surrounding Countrywide Financing, the principal buyer of Ryland's mortgages, could affect Ryland's ability to sell its mortgages. As a result, the company may have to hold a larger proportion of its mortgages on its balance sheet together with all risks associated therewith. Overall we expect Ryland's revenues from the financial segment to decline 20.3% and 30.2% in 2007 and 2008, respectively with pre-tax earnings of $32.7 and $26.5 million. However, with expected growth in Ryland's new orders we expect revenues from the financial segment to increase 8.6% and 20.6% in 2010 and 2011, respectively.

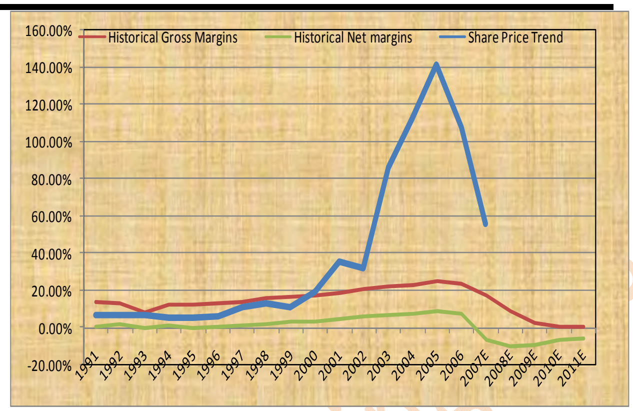
Deterioration of Ryland's revenues and gross margins





Historical trends in revenues and gross margin





Ryland's homebuilding revenues have nearly doubled from $2,286 million in 2000 to $4,654 million in 2006 with a CAGR of 12.6%. Homebuilding revenues increased 15.2% and 22.2% in 2004 and 2005, respectively to $3,867 million and $4,426 million followed by a marginal 1.5% decline in 2006 to $4,654 million. However for nine-months ended September 30, 2007 homebuilding revenues for the company witnessed a steep decline of 36.1%. Consequentially for 2007 we expect revenues to decline 39.4% to $2,821 million off 36.6% decline in home closings and a 2.1% decline in average home closing price. Going forward, we expect homebuilding revenues to decline 7.0% and 2.5%, respectively for 2008 and 2009 to $2,625 million and $2,558 million. However we expect a marginal recovery from 2010 onwards with a y-o-y 8.0%, 15.3% and 13.7% increase in homebuilding revenues in 2010, 2011 and 2012, respectively.

Ryland's gross margins including inventory impairment adjustment declined from 25.1% in 2005 to 21.5% in 2006. With a continued decline in pricing coupled with inventory impairment charges, we expect gross margins to decline to 1.9% in 2007 and subsequently we expect margins to turn to a negative of 3.5% and 2.8% in 2008 and 2009, respectively. We expect margins to be worst hit in the company's West market region with a continued double-digit negative margin from 2007 through 2012, followed by Southeast where we expect margins to be between -5% to -1% during 2008-2012. However we expect Ryland's gross margins to be relatively higher in North and Texas, with both regions expected to have positive margins, offsetting somewhat the impact of the turbulence in West and Southeast.

Impact of unconsolidated JVs

The Ryland Group Inc.

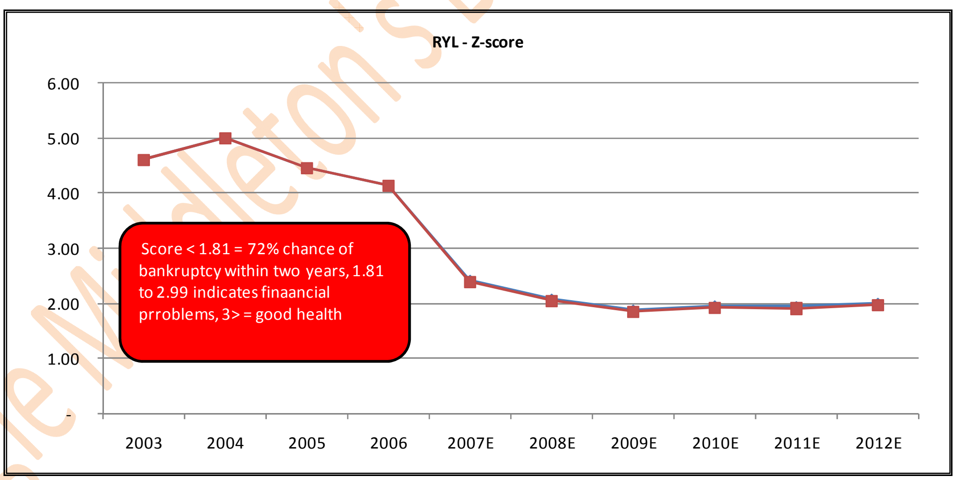
JV's Debt	**2006**	**2007E**	**2008E**	**2009E**	**2010E**	**2011E**	**2012E**
Total Assets	649.2	780.6	780.6	780.6	780.6	780.6	780.6
Total Debt	429.0	506.2	506.2	506.2	506.2	506.2	506.2
Guaranteed debt	40.4	41.7	41.7	41.7	41.7	41.7	41.7
Non-guaranteed debt	388.6	464.5	464.5	464.5	464.5	464.5	464.5
% of guaranteed debt included cosolidated on Ryland's book's		*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
% of non-guaranteed debt included on Ryland's book's		*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Total debt from VIE included on Ryland's blanace sheet		41.7	41.7	41.7	41.7	41.7	41.7
Investment in JV's	13.5	70.2	71.4	74.5	74.5	74.5	74.5

Ryland enters into joint ventures for the purpose of acquisition and co-development of land parcels and lots. Currently, the Company has 11 homebuilding joint ventures with total investments in unconsolidated joint ventures of $30.4 million as of September 30, 2007. Total debt of unconsolidated JVs as on that date was $506.2 million, out of which Ryland's exposure in the form of guaranteed debt was $41.7 million. Ryland's total exposure towards debt from unconsolidated entities is among the lowest in the industry. Unlike other homebuilding companies, Ryland prefers to buy land and has limited number of projects under joint-ventures thus limiting its off balance sheet financing.

Drop in credit ratings

Z - Score (Standalone entity)	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Working Capital / Total Assets	0.58	0.58	0.63	0.65	0.63	0.60	0.64	0.64	0.65	0.64
Retained Earnings / Total Assets	0.39	0.42	0.39	0.43	0.41	0.35	0.24	0.17	0.10	0.04
EBIT (trailing 12 months) / Total Assets	0.22	0.23	0.23	0.18	(0.09)	(0.13)	(0.10)	(0.06)	(0.06)	(0.06)
Market Value / Book Value	1.56	2.21	1.66	1.29	0.66	0.52	0.40	0.37	0.32	0.30
Sales (trailing 12 months) / Total Assets	1.72	1.63	1.42	1.39	0.98	0.99	0.88	0.95	1.05	1.19
Z-score	**4.61**	**5.00**	**4.46**	**4.14**	**2.43**	**2.09**	**1.89**	**1.96**	**1.95**	**2.01**
Credit rating	**B+**	**BB+**	**B**	**B-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**

Z - Score (Including debt from JV's)	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Working Capital / Total Assets	0.58	0.58	0.63	0.65	0.62	0.59	0.63	0.63	0.64	0.63
Retained Earnings / Total Assets	0.39	0.42	0.39	0.43	0.41	0.35	0.23	0.17	0.10	0.03
EBIT (trailing 12 months) / Total Assets	0.22	0.23	0.23	0.18	(0.09)	(0.13)	(0.10)	(0.06)	(0.06)	(0.05)
Market Value / Book Value	1.56	2.21	1.66	1.29	0.65	0.51	0.39	0.36	0.32	0.29
Sales (trailing 12 months) / Total Assets	1.72	1.63	1.42	1.39	0.96	0.98	0.87	0.93	1.03	1.17
Z-score	**4.61**	**5.00**	**4.46**	**4.14**	**2.39**	**2.05**	**1.86**	**1.93**	**1.91**	**1.97**
Credit rating	**B+**	**BB+**	**B**	**B-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**	**CCC-**



Ryland's Z-score declined from 5.0 in 2004 to 4.46 and 4.14 in 2005 and 2006, respectively. In 2007, Ryland's Z-score is expected to decline to 2.43. Expecting continued downfall in Ryland's earnings, we expect the company's Z-score to decline to 2.09 in 2008 and 1.89 in 2009. This is around the borderline of the danger zone of <1.81 indicating serious financial trouble and warning signals about potential bankruptcy. From 2010 onwards, we expect a marginal improvement in Ryland's Z-score to 1.96 and 1.95 in 2010 and 2011, with further recovery in 2012 with an expected Z-score of 2.01.

Ryland's guaranteed debt on its unconsolidated JVs is just about 3.1% of its shareholders equity. After considering the full consolidation of this guaranteed debt into Ryland's balance sheet, the company's Z-score falls to 2.39 and 2.05, in 2007 and 2008, respectively. The 2009 Z-score of 1.86 (very close to the danger zone of <1.81) indicates a strong chance of bankruptcy within the two succeeding years. However, expecting some recovery from 2010, the company's Z-score rises to 1.93 and 1.91 in 2010 and 2011, respectively which is further expected to increase to 1.97 in 2012.

Valuation

Relative approach

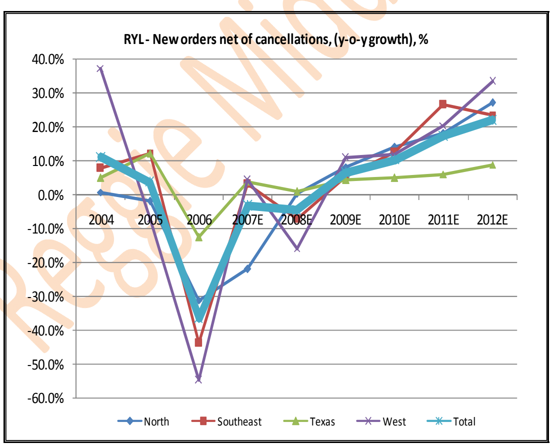
Company	Market Cap (US$ mn)	Net Debt (US$ mn)	Current EV (US$ mn)	EV/EBITDA			P/E			P/B			
				2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E	2009E
RYL Group	887	1,042	1,929	3.4	NM	NM	2.7	NM	NM	0.64	0.70	0.89	1.19
Lennar Corporation	2,413	2,984	5,397	5.5	NM	NM	4.1	NM	NM	0.43	0.50	0.59	0.70
D.R. Horton, Inc	3,365	4,960	8,325	3.7	NM	NM	2.7	NM	NM	0.52	0.61	0.61	0.62
Pulte Homes	2,440	3,375	5,815	4.6	NM	17.5	3.6	NM	10.5	0.37	0.47	0.46	0.44
KB Home	1,780	1,506	3,285	4.2	NM	NM	3.4	44.2	NM	0.52	0.60	0.65	NM
M.D.C. Holdings, Inc.	1,535	232	1,767	3.8	NM	32.2	7.2	NM	NM	0.70	0.82	0.84	0.78
Industry Average				**4.3**	**NM**	**24.9**	**4.2**	**44.2**	**10.5**	**0.51**	**0.60**	**0.63**	**0.64**

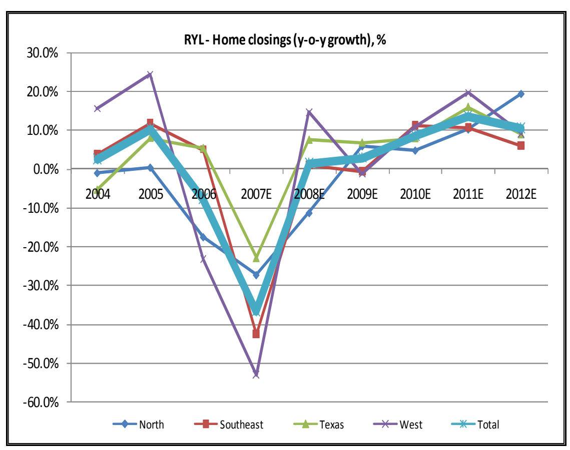
Earnings approach

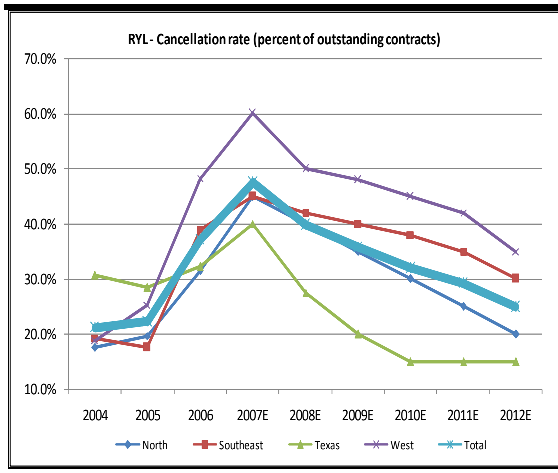
Value per share:	
Based on discounted cash flow (DCF)	(52.3)
Based on economic profit (EP)	(51.6)
Relative valuation	
Based on price/book value (P/B)	15.00

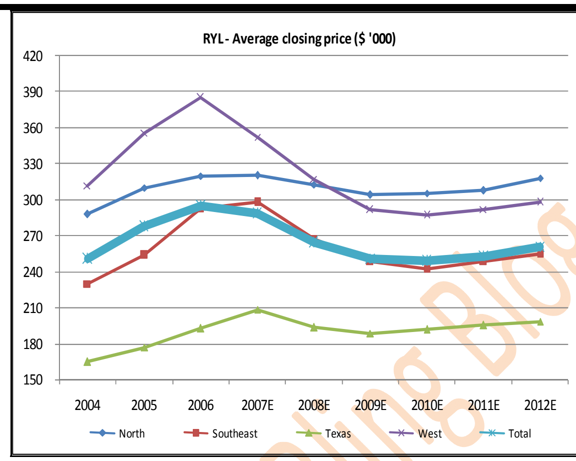
We believe that owing to considerable volatility in the current and expected earnings of homebuilding companies, earnings-based valuation including DCF and EP is not appropriate for the homebuilding sector. Based on relative valuation using P/B multiple we expect Ryland's share price is at $15.00 against current share price of $21.07 with a downward potential of 28.79%.

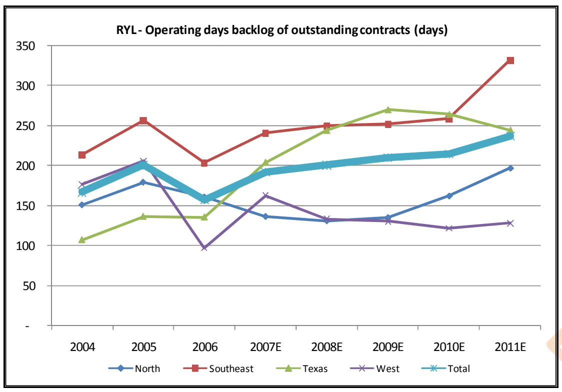
Key metrics:

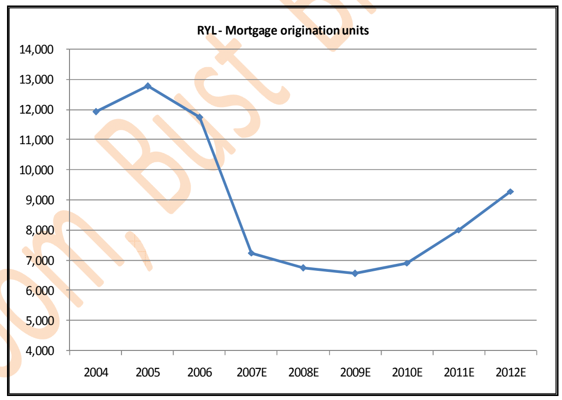












Ryland's cancellation rate has increased consistently over the past few years to reach 37.1% in 2006 from 21.2% in 2004. We expect the cancellation rate to peak in 2007 with an expected cancellation rate of 47.5% in 2007. For 2008 and 2009, we expect cancellation rate of 39.9% and 35.8%, respectively. Ryland's order backlog declined from 8,464 home units as on December 31, 2005 to 4,206 home units as on December 31, 2006, with operating backlog days declining from 201 to 157 over the period. We expect order backlog of 5,228 home units and 5,613 home units as at the end of 2007 and 2008, respectively, with operating backlog days of 192 and 201.

Credit analysis of Ryland

Credit Analysis of Ryland	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Financial position:						
Cash and cash equivalents	114	99	46	56	25	25
- % of total assets	*3.8%*	*3.7%*	*1.6%*	*1.9%*	*0.8%*	*0.8%*
Long term debt	825	750	750	950	1050	1200
Unsecured revolving credit facility	117	217	717	717	717	717
Total debt	983	1008	1508	1708	2003	2185
- debt- equity ratio	*43.6%*	*50.5%*	*67.0%*	*75.4%*	*85.0%*	*93.3%*
Ratio's:						
Leverage ratio	*40.6%*	*47.9%*	*66.3%*	*74.8%*	*85.0%*	*93.3%*
Permitted Leverage Ratio	*57.5%*	*47.5%*	*37.5%*	*35.0%*	*32.5%*	*30.0%*
Actual Tangible net worth	1,270	990	744	557	354	158
Minimum Tangible net worth	1000	1000	1000	1000	1000	1000
Pricing grid:						
Applicable margin on revolving credit facility	*0.875%*	*0.875%*	*1.500%*	*1.500%*	*1.500%*	*1.500%*
Applicable fee rate	*0.20%*	*0.20%*	*0.25%*	*0.25%*	*0.25%*	*0.25%*
Ratings:						
Reggie's rating	CCC-	CCC-	CCC-	CCC-	CCC-	CCC-
Mood's rating	BBB-	BBB-	BB	BB	BB	BB
S&P Rating	Baa3	Baa3	Ba2	Ba2	Ba2	Ba2
Interest rates:						
LIBOR + Margin	*5.9%*	*5.9%*	*6.5%*	*6.5%*	*6.5%*	*6.5%*
Effective interest rate	*4.4%*	*5.6%*	*6.4%*	*6.6%*	*6.8%*	*6.7%*

Overall we expect company's cash position to deteriorate with cash and cash equivalents as percentage of total assets to decline from an expected 3.8% in 2007 to 1.6% in 2009. To maintain its cash requirements, we expect Ryland's borrowing under its revolving credit facility to increase to $717 million by 2009. (Currently Ryland utilizes only $117 million of the total limit of $750 million under its revolving credit facility). Owing to increase in debt, we believe Ryland would not be able to meet its conditions set forth under its debt covenants from 4Q2008 onwards. Resultantly, we expect company's financing cost to increase from 4.4% in 2007 to 5.4% in 2009, which is further expected to peak out by 2011 with an effective interest rate of 6.8%.

The Ryland Group Inc.
($ millions except percent figures)

FY ended Dec. 31	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**	**2010E**	**2011E**	**2012E**
Consolidated Statements of Earnings									
Revenues:									
Homebuilding	3,867.1	4,725.8	4,653.9	2,820.6	2,624.5	2,557.9	2,762.6	3,185.4	3,622.5
Financial Services	84.7	91.8	103.3	61.0	46.3	42.9	46.6	56.2	68.1
Total revenues	3,951.8	4,817.6	4,757.2	2,881.6	2,670.8	2,600.9	2,809.2	3,241.6	3,690.6
Expenses:									
Cost of sales	2,964.1	3,537.6	3,640.1	2,766.5	2,717.6	2,628.5	2,753.4	3,168.5	3,551.3
Impairment adjustments and deposit write-offs	-	-	76.5	438.5	317.4	139.6	-	-	-
Other operating costs	2,964.1	3,537.6	3,563.5	2,327.9	2,400.2	2,488.9	2,753.4	3,168.5	3,551.3
Investment in unconsolidated JVs writte-downs	-	-	-	1.9	(1.2)	(3.2)	-	-	-
Selling, general and administrative	377.5	443.9	440.7	345.6	289.9	259.3	247.5	278.4	322.3
Financial services	28.0	32.4	35.6	28.4	19.8	18.4	19.9	24.0	29.1
Corporate	60.9	74.3	66.0	35.4	40.6	39.5	42.7	49.3	56.1
Expenses related to early retirement of debt	-	8.3	7.7	0.3	-	-	-	-	-
Total expenses	3,430.6	4,096.6	4,190.1	3,176.0	3,067.9	2,945.7	3,063.6	3,520.1	3,958.8
Earnings before taxes	521.3	721.0	567.1	(294.5)	(397.1)	(344.8)	(254.4)	(278.5)	(268.2)
Tax expense/(benefit)	200.7	274.0	207.2	(110.1)	(136.7)	(118.7)	(87.6)	(95.9)	(92.3)
Net earnings	320.6	447.0	360.0	(184.4)	(260.4)	(226.1)	(166.8)	(182.6)	(175.9)
Net earnings per common share									
Basic	6.72	9.52	8.14	(4.38)	(6.21)	(5.39)	(3.98)	(4.35)	(4.19)
Diluted	6.36	9.03	7.84	(4.38)	(6.21)	(5.39)	(3.98)	(4.35)	(4.19)
Average common shares outstanding (in millions)									
Basic	48	47	44	42	42	42	42	42	42
Diluted	50	49	46	42	42	42	42	42	42
Dividend per common share ($)	0.21	0.3	0.48	0.48	0.48	0.48	0.48	0.48	0.48

Key ratios

Debt-to-capital, X	34.6%	40.1%	38.6%	43.6%	50.5%	67.0%	75.4%	85.0%	93.3%
SG&A/ revenues, %	9.6%	9.2%	9.3%	12.0%	10.9%	10.0%	8.8%	8.6%	8.7%
Effective tax rate	38.5%	38.0%	36.5%	37.4%	34.4%	34.4%	34.4%	34.4%	34.4%
Working Capital / Total Assets	0.58	0.63	0.65	0.63	0.60	0.64	0.64	0.65	0.64
Retained Earnings / Total Assets	0.42	0.39	0.43	0.41	0.35	0.24	0.17	0.10	0.04
EBIT (trailing 12 months) / Total Assets	0.23	0.23	0.18	(0.09)	(0.13)	(0.10)	(0.06)	(0.06)	(0.06)
Market Value of Equities / Book Value of Liablities	2.21	1.66	1.29	0.66	0.52	0.40	0.37	0.32	0.30
Share price as of period-end	*63.3*	*70.9*	*55.6*	*26.5*	*21.1*	*21.1*	*21.1*	*21.1*	*21.1*
No. of shares	*47.7*	*47.0*	*44.2*	*42.1*	*42.0*	*42.0*	*42.0*	*42.0*	*42.0*
Market value of equity at period-end	*3,018.1*	*3,329.9*	*2,457.8*	*1,117.2*	*884.1*	*884.1*	*884.1*	*884.1*	*884.1*
Sales (trailing 12 months) / Total Assets	1.63	1.42	1.39	0.98	0.99	0.88	0.95	1.05	1.19

Consolidated Balance Sheets	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**	**2010E**	**2011E**	**2012E**
Assets:									
Cash and cash equivalents	88.4	461.4	215.0	113.5	98.6	45.9	56.4	25.0	25.0
Housing inventories:									
Homes under construction	1,002.2	1,253.5	1,079.7	1,061.3	929.0	1,123.5	1,055.9	1,120.8	1,062.5
Land under development and improved lots	877.8	1,087.0	1,427.9	1,102.3	996.5	1,122.2	1,201.9	1,287.2	1,352.3
Consolidated inventory not owned	144.1	239.2	263.9	147.0	147.0	147.0	147.0	147.0	147.0
Total inventories	2,024.1	2,579.7	2,771.5	2,310.6	2,072.5	2,392.7	2,404.8	2,555.1	2,561.9
Property, plant and equipment	50.3	66.0	76.9	78.6	69.7	64.2	55.4	53.2	54.6
Net deferred taxes	45.7	50.1	84.2	176.3	176.3	176.3	176.3	176.3	176.3
Purchase price in excess of net assets acquired	18.2	18.2	18.2	-	-	-	-	-	-
Other	198.3	211.6	250.9	271.6	271.6	271.6	271.6	271.6	271.6
Total assets	2,425.0	3,386.9	3,416.7	2,950.7	2,688.8	2,950.7	2,964.4	3,081.2	3,089.3
Liabilities:									
Accounts payable	200.6	249.5	186.9	160.8	154.3	162.6	163.3	188.0	210.7
Accrued and other liabilities	500.8	664.7	586.8	400.8	400.8	400.8	400.8	400.8	400.8
Debt	558.9	922.0	950.1	983.3	1,008.3				
Total liabilities	1,260.4	1,836.2	1,723.8	1,544.9	1,563.5	2,071.7	2,272.5	2,591.9	2,796.1
Minority interest	107.8	174.7	181.7	135.4	135.4	135.4	135.4	135.4	135.4
Stockholders' equity:									
Common stock	47.3	46.4	42.6	42.0	42.0	42.0	42.0	42.0	42.0
Retained earnings	1,009.2	1,326.7	1,463.7	1,224.1	943.6	697.3	510.4	307.6	111.6
Accumulated other comprehensive income	0.2	3.0	4.8	4.2	4.2	4.2	4.2	4.2	4.2
Total stockholders' equity	1,056.8	1,376.0	1,511.2	1,270.4	989.9	743.6	556.6	353.8	157.8
Total liabilities and stockholders' equity	2,425.0	3,386.9	3,416.7	2,950.7	2,688.7	2,950.7	2,964.5	3,081.1	3,089.3

Consolidated Statements of Cash Flows	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Cash flows from operating activities:									
Net earnings	320.6	447.0	360.0	(184.4)	(260.4)	(226.1)	(166.8)	(182.6)	(175.9)
Adjustments to reconcile net earnings to net cash provided by operating activities:									
Depreciation and amortization	38.5	43.2	46.7	52.4	36.4	32.9	39.0	35.4	35.1
Stock-based compensation expense	15.2	18.9	25.6	10.0	-	-	-	-	-
Changes in assets and liabilities:	-	-	-	-	-	-	-	-	-
Decrease (increase) in inventories	(585.6)	(491.0)	(182.7)	423.6	238.1	(320.2)	(12.1)	(150.2)	(6.8)
Change in other asset & liabilities	104.4	175.4	(216.9)	(319.1)	(6.5)	8.3	0.8	24.6	22.7
Tax benefit from stock options	17.5	30.5	-	(5.8)	-	-	-	-	-
Excess tax benefits from stock-based compensation	-	-	(14.6)	-	-	-	-	-	-
Other operating activities, net	10.9	(7.7)	(3.4)	(16.9)	-	-	-	-	-
Net cash provided by (used for) operating activities	(78.4)	216.2	14.7	(40.0)	7.6	(505.2)	(139.2)	(272.9)	(124.9)
Cash flows from investing activities:									
Net additions to property, plant and equipment	(47.1)	(55.1)	(53.8)	(35.7)	(27.4)	(27.4)	(30.2)	(33.2)	(36.5)
Principal reduction of MBS, notes and mortgage	19.3	12.6	2.3	0.8	0.0	0.0	0.0	0.0	0.0
Net cash used for investing activities	(27.8)	(42.6)	(51.6)	(35.0)	(27.4)	(27.4)	(30.1)	(33.1)	(36.5)
	-	-	-	-	-	-	-	-	-
Cash flows from financing activities:	-	-	-	-	-	-	-	-	-
Net borrowings against revolving credit facility	-	-	-	117.0	100.0	500.0	-	-	-
Cash proceeds of long-term debt	-	500.0	250.0	-	-	-	-	-	-
Repayment of long-term debt	-	(147.0)	(243.5)	(75.0)	(75.0)	-	200.0	100.0	150.0
Increase (decrease) in short-term borrowings	(14.9)	10.0	21.6	(8.8)	-	-	-	-	-
Common stock dividends	(9.7)	(11.4)	(21.7)	(20.3)	(20.1)	(20.1)	(20.1)	(20.1)	(20.1)
Common stock repurchases	(118.3)	(176.2)	(250.1)	(59.3)	-	-	-	-	-
Issuance of common stock under ESOP	23.5	29.3	19.7	14.2	-	-	-	-	-
Excess tax benefits from stock-based compensation	-	-	14.6	5.8	-	-	-	-	-
Other financing activities, net	(2.7)	(5.4)	(0.0)	(0.0)	-	-	-	-	-
Net cash (used for) provided by financing activities	(122.1)	199.3	(209.4)	(26.5)	4.9	479.9	179.9	79.9	129.9
Net (decrease) increase in cash and cash equivalents	(228.3)	373.0	(246.3)	(101.5)	(14.9)	(52.7)	10.5	(226.2)	(31.5)
Cash and cash equivalents at beginning of year	316.7	88.4	461.4	215.1	113.5	98.6	45.9	56.4	25.0
Cash before temprory funding arrangeemnts	88.4	461.4	215.1	113.5	98.6	45.9	56.4	(169.8)	(6.5)
Short-term temporary fundings	-	-	-	-	-	-	-	194.8	31.5
Cash and cash equivalents at end of year	88.4	461.4	215.1	113.5	98.6	45.9	56.4	25.0	25.0

Key metrics

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Operating metrics									
New orders net of cancellations, (y-o-y growth)									
North	0.8%	-1.9%	-31.1%	-21.8%	0.3%	8.3%	14.0%	18.2%	27.2%
Southeast	7.8%	12.4%	-43.8%	3.1%	-7.2%	5.3%	12.4%	26.7%	23.6%
Texas	5.0%	12.2%	-12.6%	3.9%	1.0%	4.4%	5.0%	6.1%	8.9%
West	37.4%	-7.2%	-54.7%	4.5%	-15.7%	11.0%	12.0%	20.4%	33.6%
Total	**11.1%**	**3.8%**	**-36.4%**	**-3.1%**	**-4.5%**	**6.6%**	**10.3%**	**17.3%**	**22.0%**
Cancellation rate (% of outstanding contracts)									
North	17.5%	19.7%	31.5%	45.0%	40.0%	35.0%	30.0%	25.0%	20.0%
Southeast	19.3%	17.6%	39.0%	45.0%	42.0%	40.0%	38.0%	35.0%	30.0%
Texas	30.6%	28.4%	32.2%	40.0%	27.5%	20.0%	15.0%	15.0%	15.0%
West	18.9%	25.3%	48.3%	60.0%	50.0%	48.0%	45.0%	42.0%	35.0%
Total	**21.2%**	**22.3%**	**37.1%**	**47.5%**	**39.9%**	**35.8%**	**32.0%**	**29.3%**	**25.0%**
Home closings (y-o-y growth)									
North	-1.0%	0.4%	-17.5%	-27.2%	-11.3%	5.9%	4.8%	10.2%	19.4%
Southeast	3.7%	11.7%	4.9%	-42.6%	1.0%	-0.8%	11.2%	10.5%	6.0%
Texas	-5.3%	8.0%	5.4%	-22.8%	7.5%	6.8%	7.9%	15.9%	8.9%
West	15.5%	24.3%	-23.1%	-53.0%	14.5%	-1.3%	10.8%	19.5%	9.0%
Total	**2.6%**	**10.4%**	**-7.7%**	**-36.6%**	**1.6%**	**3.0%**	**8.6%**	**13.6%**	**10.4%**
Average closing price ($ '000)									
North	288	310	320	320	313	304	306	308	318
Southeast	230	254	293	298	268	249	243	248	255
Texas	165	177	193	209	194	189	192	196	199
West	312	356	385	352	317	291	287	292	298
Total	**251**	**278**	**295**	**289**	**265**	**251**	**249**	**253**	**261**
Operating days backlog of outstanding contracts									
North	151	180	161	136	131	135	162	197	-
Southeast	213	256	203	241	250	252	259	332	-
Texas	108	137	136	205	244	270	264	245	-
West	177	206	97	163	134	130	122	128	-
Total	**167**	**201**	**157**	**192**	**201**	**210**	**215**	**237**	**-**
Mortgage origination units	**11,920**	**12,774**	**11,744**	**7,251**	**6,742**	**6,567**	**6,915**	**8,012**	**9,291**

Financial metrics									
Revenues (y-o-y growth)									
North	11.0%	8.1%	-13.8%	-29.4%	-13.8%	3.0%	5.3%	11.1%	23.3%
Southeast	13.4%	24.4%	21.0%	-42.1%	-9.8%	-8.0%	8.6%	13.0%	8.9%
Texas	0.2%	16.1%	12.3%	-17.9%	-0.2%	4.2%	9.7%	18.1%	10.5%
West	34.1%	40.6%	-15.1%	-57.7%	1.5%	-9.2%	9.2%	21.5%	11.2%
Total	**15.3%**	**22.2%**	**-1.5%**	**-39.4%**	**-7.0%**	**-2.5%**	**8.0%**	**15.3%**	**13.7%**
Gross margins									
North	27.0%	26.3%	23.3%	13.2%	9.3%	9.6%	9.5%	8.6%	10.6%
Southeast	21.3%	23.5%	25.9%	10.3%	-4.9%	-4.5%	-3.8%	-2.7%	-1.5%
Texas	17.8%	17.7%	18.9%	16.9%	8.5%	5.0%	5.4%	6.1%	6.5%
West	23.7%	28.7%	17.0%	-46.7%	-31.9%	-28.7%	-13.4%	-12.7%	-11.8%
Total	23.4%	25.1%	21.8%	1.9%	-3.5%	-2.8%	0.3%	0.5%	2.0%
Gross margins (excluding impairment and write-downs)									
North	27.0%	26.3%	23.8%	18.3%	14.4%	11.6%	9.5%	8.6%	10.6%
Southeast	21.3%	23.5%	26.2%	20.7%	9.3%	0.2%	-3.8%	-2.7%	-1.5%
Texas	17.8%	17.7%	19.7%	17.1%	8.5%	5.0%	5.4%	6.1%	6.5%
West	23.7%	28.7%	21.7%	11.1%	-0.5%	-10.2%	-13.4%	-12.7%	-11.8%
Total	23.4%	25.1%	23.4%	17.5%	8.5%	2.7%	0.3%	0.5%	2.0%
SG&A expenses (percent of revenues)									
North	8.7%	8.9%	9.0%	10.5%	10.0%	9.4%	9.4%	9.0%	9.5%
Southeast	10.5%	9.3%	9.2%	11.4%	11.3%	10.7%	8.5%	8.5%	8.5%
Texas	10.9%	10.5%	10.3%	11.7%	11.2%	10.6%	9.0%	8.5%	8.5%
West	9.7%	9.5%	9.7%	17.1%	12.0%	10.0%	9.0%	9.0%	9.0%
Total	**9.8%**	**9.4%**	**9.5%**	**12.3%**	**11.0%**	**10.1%**	**9.0%**	**8.7%**	**8.9%**
EBIT margin	14.3%	15.9%	12.9%	-8.9%	-13.2%	-11.3%	-6.8%	-6.1%	-4.6%
EPS, diluted (y-o-y growth)	39.7%	41.9%	-13.3%	-155.9%	41.7%	-13.2%	-26.2%	9.5%	-3.7%
Debt to capital ratio	34.6%	40.1%	38.6%	43.6%	50.5%	67.0%	75.4%	85.0%	93.3%