KB HOME
Form 10-Q
October 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended August 31, 2018.
or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from [ ] to [ ].
Commission File No. 001-09195
KB HOME
(Exact name of registrant as specified in its charter)
Delaware 95-3666267
(State of incorporation) (IRS employer identification number)
10990 Wilshire Boulevard
Los Angeles, California 90024
(310) 231-4000
(Address and telephone number of principal executive offices)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock as of August 31, 2018.
There were 88,387,928 shares of the registrant's common stock, par value $1.00 per share, outstanding on August 31, 2018. The registrant's grantor stock ownership trust held an additional 8,460,265 shares of the registrant's common stock on that date.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts – Unaudited)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2018	2017	2018	2017
Total revenues	$1,225,347	$1,144,001	$3,198,393	$2,965,391
Homebuilding:				
Revenues	$1,221,875	$1,140,787	$3,189,753	$2,957,105
Construction and land costs	(1,001,509)	(955,001)	(2,642,231)	(2,499,677)
Selling, general and administrative expenses	(114,753)	(109,095)	(323,708)	(305,901)
Operating income	105,613	76,691	223,814	151,527
Interest income	458	347	2,739	747
Interest expense	—	—	—	(6,307)
Equity in income (loss) of unconsolidated joint ventures	3,493	(814)	2,326	(679)
Homebuilding pretax income	109,564	76,224	228,879	145,288
Financial services:				
Revenues	3,472	3,214	8,640	8,286
Expenses	(945)	(890)	(2,855)	(2,525)
Equity in income of unconsolidated joint ventures	2,585	660	4,365	1,600
Financial services pretax income	5,112	2,984	10,150	7,361
Total pretax income	114,676	79,208	239,029	152,649
Income tax expense	(27,200)	(29,000)	(165,500)	(56,400)
Net income	$87,476	$50,208	$73,529	$96,249
Earnings per share:				
Basic	$.99	$.58	$.83	$1.12
Diluted	$.87	$.51	$.75	$1.00
Weighted average shares outstanding:				
Basic	87,951	85,974	87,565	85,517
Diluted	101,072	98,912	101,213	97,624
Cash dividends declared per common share	$.025	$.025	$.075	$.075

See accompanying notes.

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CONSOLIDATED BALANCE SHEETS
(In Thousands – Unaudited)

	August 31, 2018	November 30, 2017
Assets		
Homebuilding:		
Cash and cash equivalents	$354,361	$720,630
Receivables	279,608	244,213
Inventories	3,688,855	3,263,386
Investments in unconsolidated joint ventures	62,436	64,794
Deferred tax assets, net	468,969	633,637
Other assets	108,919	102,498
	4,963,148	5,029,158
Financial services	11,541	12,357
Total assets	$4,974,689	$5,041,515
Liabilities and stockholders’ equity		
Homebuilding:		
Accounts payable	$259,947	$213,463
Accrued expenses and other liabilities	634,466	575,930
Notes payable	2,063,127	2,324,845
	2,957,540	3,114,238
Financial services	1,200	966
Stockholders’ equity:		
Common stock	119,049	117,946
Paid-in capital	750,254	727,483
Retained earnings	1,802,538	1,735,695
Accumulated other comprehensive loss	(16,924)	(16,924)
Grantor stock ownership trust, at cost	(91,760)	(96,509)
Treasury stock, at cost	(547,208)	(541,380)
Total stockholders’ equity	2,015,949	1,926,311
Total liabilities and stockholders’ equity	$4,974,689	$5,041,515

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands – Unaudited)

	Nine Months Ended August 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$73,529	$96,249
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Equity in income of unconsolidated joint ventures	(6,691)	(921)
Distributions of earnings from unconsolidated joint ventures	6,297	—
Amortization of discounts and issuance costs	4,677	5,006
Depreciation and amortization	1,882	2,151
Deferred income taxes	164,668	55,900
Loss on early extinguishment of debt	—	5,685
Stock-based compensation	12,149	9,893
Inventory impairments and land option contract abandonments	19,925	18,122
Changes in assets and liabilities:		
Receivables	(36,030)	2,172
Inventories	(370,048)	(95,850)
Accounts payable, accrued expenses and other liabilities	84,885	9,926
Other, net	(4,751)	(5,063)
Net cash provided by (used in) operating activities	(49,508)	103,270
Cash flows from investing activities:		
Contributions to unconsolidated joint ventures	(15,640)	(15,154)
Return of investments in unconsolidated joint ventures	9,934	8,159
Purchases of property and equipment, net	(4,137)	(6,643)
Net cash used in investing activities	(9,843)	(13,638)
Cash flows from financing activities:		
Repayment of senior notes	(300,000)	(105,326)
Borrowings under revolving credit facility	70,000	—
Repayments under revolving credit facility	(70,000)	—
Issuance costs for unsecured revolving credit facility	—	(1,711)
Payments on mortgages and land contracts due to land sellers and other loans	(10,494)	(92,443)
Issuance of common stock under employee stock plans	17,433	20,677
Payments of cash dividends	(6,686)	(6,479)
Tax payments associated with stock-based compensation awards	(6,787)	(2,543)
Net cash used in financing activities	(306,534)	(187,825)
Net decrease in cash and cash equivalents	(365,885)	(98,193)
Cash and cash equivalents at beginning of period	720,861	593,000
Cash and cash equivalents at end of period	$354,976	$494,807

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with GAAP have been condensed or omitted.

In our opinion, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly our consolidated financial position as of August 31, 2018, the results of our consolidated operations for the three months and nine months ended August 31, 2018 and 2017, and our consolidated cash flows for the nine months ended August 31, 2018 and 2017. The results of our consolidated operations for the three months and nine months ended August 31, 2018 are not necessarily indicative of the results to be expected for the full year due to seasonal variations in operating results and other factors. The consolidated balance sheet at November 30, 2017 has been taken from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2017, which are contained in our Annual Report on Form 10-K for that period.

Unless the context indicates otherwise, the terms "we," "our," and "us" used in this report refer to KB Home, a Delaware corporation, and its subsidiaries.

Use of Estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents. We consider all highly liquid short-term investments purchased with an original maturity of three months or less to be cash equivalents. Our cash equivalents totaled $195.7 million at August 31, 2018 and $481.1 million at November 30, 2017. At August 31, 2018 and November 30, 2017, the majority of our cash and cash equivalents was invested in interest-bearing bank deposit accounts.

Comprehensive Income. Our comprehensive income was $87.5 million for the three months ended August 31, 2018 and $50.2 million for the three months ended August 31, 2017. For the nine months ended August 31, 2018 and 2017, our comprehensive income was $73.5 million and $96.2 million, respectively. Our comprehensive income for each of the three-month and nine-month periods ended August 31, 2018 and 2017 was equal to our net income for the respective periods.

Adoption of New Accounting Pronouncements. In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-09, "Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"), which simplified several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of excess tax benefits on the statement of cash flows, treatment of forfeitures, and statutory withholding requirements. We adopted this guidance effective December 1, 2017. ASU 2016-09 requires excess tax benefits and deficiencies from stock-based compensation awards to be recognized prospectively in our consolidated statements of operations as a component of income tax expense, whereas these items were previously recorded in paid-in capital in our consolidated balance sheets. This guidance also requires excess tax benefits to be classified within operating activities in the consolidated statements of cash flows. We previously recognized excess tax benefits as a cash inflow from financing activities and a corresponding cash outflow from operating activities. In connection with the adoption of this guidance, we elected to continue to estimate forfeitures in calculating our stock-based compensation expense, rather than account for forfeitures as they occur. The impact of recognizing excess tax benefits and deficiencies in our consolidated statements of operations resulted in reductions in our income tax expense of $.6 million and $3.0 million for the three-month and nine-month periods ended August 31, 2018, respectively. The remaining aspects of adopting this guidance did not have a material impact on our consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”). ASU 2017-01 clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for annual and interim periods beginning after December 15, 2017 (with early adoption permitted). Our early adoption of this guidance in the 2018 third quarter did not have a material impact on our consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted. In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 supersedes the revenue guidance in Accounting Standards Codification Topic 605, “Revenue Recognition,” and most industry-specific revenue and cost guidance in the accounting standards codification, including some cost guidance related to construction-type and production-type contracts. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a principles-based, five-step model to be applied to contracts with customers in determining the timing and amount of revenue to recognize: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract, if applicable; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Certain contracts may contain terms that require more management judgment and estimates than currently applicable guidance to determine the appropriate revenue recognition, including with respect to identifying the performance obligations in the contract, estimating the amount of variable consideration, if any, to include in the transaction price, and allocating the transaction price to the applicable performance obligations, among other things.

ASU 2014-09 and its related amendments (collectively, “ASC 606”) are effective for us beginning December 1, 2018. We intend to adopt ASC 606 under the modified retrospective method applied to contracts that are not complete as of the date of adoption. As a result, we expect to record a cumulative adjustment to beginning retained earnings as of December 1, 2018. We do not expect the adoption of ASC 606 to have a material impact on our recognition of homebuilding revenues in our consolidated financial statements. The primary impacts to our consolidated financial statements are expected to be the following:

- Within our homebuilding operations, ASC 606 will impact the classification and timing of recognition in our consolidated financial statements of certain community sales office, model and other marketing-related costs, which we currently capitalize to inventories and amortize through construction and land costs with each home delivered in a community. Under ASC 606, these costs will be capitalized to property and equipment and depreciated to selling, general and administrative expenses, or will be expensed as incurred. Upon adopting ASC 606, we will reclassify certain of these community sales office, model and other marketing-related costs from inventories to property and equipment in our consolidated financial statements. The change in the classification and timing of these costs will also result in lower construction and land costs, and higher selling, general and administrative expenses, as compared to amounts reported under the existing guidance. In addition, under ASC 606, forfeited customer deposits, which are currently reflected as other income, will be included in revenues.

- Within our financial services operations, ASC 606 will impact the timing of recognition of insurance commissions for insurance policy renewals. We currently recognize insurance commissions for renewals as revenue when policies are renewed. Under ASC 606, insurance commissions for estimated future policy renewals will be recognized as revenue when the customer executes an initial insurance policy with the insurance carrier. Upon adopting ASC 606, we will record a contract asset for the estimated future renewal commissions related to existing policies as of December 1, 2018.

We are in the process of quantifying the above-mentioned items. While individual financial statement line items may be affected, we currently believe the adoption of ASC 606 will not have a material impact on our consolidated net income. In addition, we do not expect significant changes to our business processes or internal control over financial reporting as a result of the adoption. We are also continuing to evaluate the impact that adopting this guidance may have on other aspects of our business.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). ASU 2016-02 will require lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under this guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities are to be expanded to include qualitative along with specific quantitative information. ASU 2016-02 is effective for us beginning December 1, 2019 (with early adoption permitted). Originally, entities were required to adopt ASU 2016-02 using a modified retrospective transition method. However, in July 2018, the FASB issued ASU 2018-11, “Leases (Topic 842): Targeted Improvements,” which provides entities with an additional transition method. Under ASU 2018-11, entities have the option of recognizing the cumulative effect of applying the new standard as an adjustment to beginning retained earnings in the year of adoption while continuing to present all prior periods under previous lease accounting guidance. In July 2018, the FASB also issued Accounting Standards Update No. 2018-10, “Codification Improvements to Topic 842, Leases” (“ASU 2018-10”), which clarifies how to apply certain aspects of ASU 2016-02. We expect to adopt ASU 2016-02, ASU 2018-10 and ASU 2018-11 beginning December 1, 2019. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, "Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act ("TCJA"), and requires certain disclosures about stranded tax effects. ASU 2018-02 is effective for us beginning December 1, 2019 (with early adoption permitted), and shall be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the corporate income tax rate in the TCJA is recognized. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement" ("ASU 2018-13"), which modifies the disclosure requirements on fair value measurements by removing, modifying, or adding certain disclosures. ASU 2018-13 is effective for us beginning December 1, 2020 (with early adoption permitted). Certain disclosures in ASU 2018-13 are required to be applied on a retrospective basis and others on a prospective basis. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update No. 2018-14, "Compensation — Retirement Benefits — Defined Benefit Plans — General (Subtopic 715-20): Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans" ("ASU 2018-14"), which modifies the disclosure requirements for employers that sponsor defined benefit plans or other postretirement plans. ASU 2018-14 is effective for our year ending November 30, 2021 (with early adoption permitted). ASU 2018-14 is required to be applied on a retrospective basis to all periods presented. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update No. 2018-15, "Intangibles — Goodwill and Other — Internal-Use Software — (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" ("ASU 2018-15"), which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard is effective for us beginning December 1, 2020 (with early adoption permitted). ASC 2018-15 is required to be applied either retrospectively or prospectively to all implementation costs after the date of adoption. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

2. Segment Information

We have identified five operating reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment. As of August 31, 2018, our homebuilding reporting segments conducted ongoing operations in the following states:

West Coast: California and Washington
Southwest: Arizona and Nevada
Central: Colorado and Texas
Southeast: Florida and North Carolina

In the 2018 third quarter, we expanded into Washington with our entrance into the Seattle market.

Our homebuilding reporting segments are engaged in the acquisition and development of land primarily for residential purposes and offer a wide variety of homes that are designed to appeal to first-time, first move-up and active adult homebuyers. Our homebuilding operations generate most of their revenues from the delivery of completed homes to homebuyers. They also earn revenues from the sale of land.

Our homebuilding reporting segments were identified based primarily on similarities in economic and geographic characteristics, product types, regulatory environments, methods used to sell and construct homes and land acquisition characteristics. Management evaluates segment performance primarily based on segment pretax results.

Our financial services reporting segment offers property and casualty insurance and, in certain instances, earthquake, flood and personal property insurance to our homebuyers in the same markets as our homebuilding reporting segments, and provides title services in the majority of our markets located within our Central and Southeast homebuilding reporting segments. This segment earns revenues primarily from insurance commissions and from the provision of title services.

In 2016, a subsidiary of ours and a subsidiary of Stearns Lending, LLC (“Stearns”) formed KBHS Home Loans, LLC (“KBHS”), an unconsolidated mortgage banking joint venture to offer mortgage banking services, including mortgage loan originations, to our homebuyers. We and Stearns each have a 50.0% ownership interest in KBHS, with Stearns providing management oversight of KBHS’ operations. KBHS was operational in all of our served markets as of June 2017. The financial services reporting segment is separately reported in our consolidated financial statements.

Corporate and other is a non-operating segment that develops and oversees the implementation of company-wide strategic initiatives and provides support to our reporting segments by centralizing certain administrative functions. Corporate management is responsible for, among other things, evaluating and selecting the geographic markets in which we operate, consistent with our overall business strategy; allocating capital resources to markets for land acquisition and development activities; making major personnel decisions related to employee compensation and benefits; and monitoring the financial and operational performance of our divisions. Corporate and other includes general and administrative expenses related to operating our corporate headquarters. A portion of the expenses incurred by Corporate and other is allocated to our homebuilding reporting segments.

Our reporting segments follow the same accounting policies used for our consolidated financial statements. The results of each reporting segment are not necessarily indicative of the results that would have occurred had the segment been an independent, stand-alone entity during the periods presented, nor are they indicative of the results to be expected in future periods.

The following tables present financial information relating to our homebuilding reporting segments (in thousands):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2018	2017	2018	2017
Revenues:				
West Coast	$571,880	$609,598	$1,455,272	$1,426,030
Southwest	196,056	132,307	528,872	376,132
Central	327,888	291,006	885,875	826,008
Southeast	126,051	107,876	319,734	328,935
Total	$1,221,875	$1,140,787	$3,189,753	$2,957,105

Pretax income (loss):