

## KB Home(KBH)

**\$36.26** (As of 01/07/20)

Price Target (6-12 Months): **\$38.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 11/26/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: A

## Summary

Shares of the company have outperformed its industry in the past year. We are further encouraged after the company reported better-than-expected earnings in third-quarter fiscal 2019. The results mainly benefited from continued progress of the Returns-Focused Growth plan, given stellar average community count growth of 18% year over year. Although the company's top and bottom lines declined on a year-over-year basis, it remains upbeat about improvement in fiscal fourth-quarter results. The company believes that solid backlog level (\$2.3 billion), declining mortgage rates, steady economic growth and favorable demographics will continue providing a healthy backdrop for the housing industry, thereby helping it to grow further in fiscal 2020. However, lower average selling price is a concern.

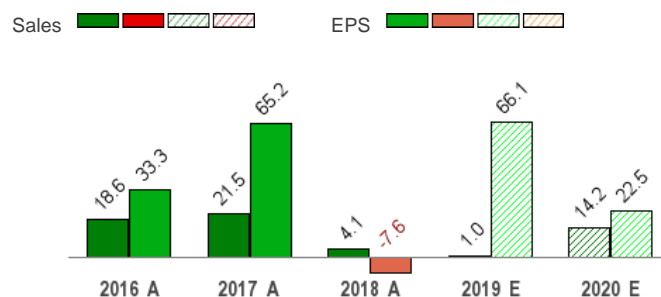
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	\$37.40 - \$19.26
20 Day Average Volume (sh)	1,236,810
Market Cap	\$3.2 B
YTD Price Change	5.8%
Beta	1.24
Dividend / Div Yld	\$0.36 / 1.0%
Industry	<a href="#">Building Products - Home Builders</a>
Zacks Industry Rank	Top 43% (109 out of 254)

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.3%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	0.8%
Expected Report Date	01/09/2020
Earnings ESP	-2.3%
P/E TTM	14.5
P/E F1	10.4
PEG F1	1.3
P/S TTM	0.7

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	979 E	1,249 E	1,325 E	1,693 E	5,248 E
2019	811 A	1,022 A	1,161 A	1,605 E	4,594 E
2018	872 A	1,101 A	1,225 A	1,349 A	4,547 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.45 E	\$0.72 E	\$0.91 E	\$1.43 E	\$3.48 E
2019	\$0.31 A	\$0.51 A	\$0.73 A	\$1.30 E	\$2.84 E
2018	\$0.40 A	\$0.57 A	\$0.87 A	\$0.96 A	\$1.71 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/07/2020. The reports text is as of 01/08/2020.

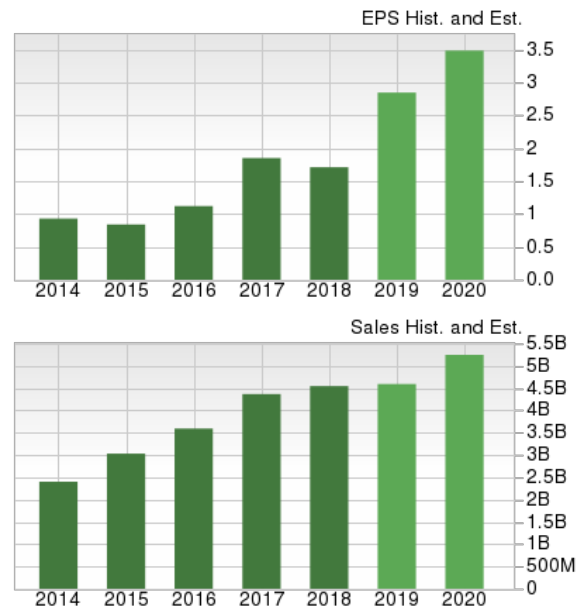
## Overview

Based in Los Angeles, CA, **KB Home** is a well-known homebuilder in the United States and one of the largest in the state. The company's revenues are generated from its **Homebuilding** (accounting for 99.7% of third-quarter fiscal 2019 total revenues) and **Financial Services** (0.3%) operations.

The company's Homebuilding operations include building and designing homes that cater to first time, move-up and active adult homebuyers on acquired or developed lands. KB Home also builds attached and detached single-family homes, town homes and condominiums.

There are four main reportable segments based on geographical presence: West Coast (comprising California), Southwest (comprising Arizona and Nevada), Central (constituting Colorado and Texas) and Southeast (including Florida, Maryland, North Carolina and Virginia).

KB Home's Financial Services operations offer mortgage banking, title and insurance services to homebuyers.



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## Reasons To Buy:

- ▲ **Growth Initiatives to Drive Profits:** Since 2016, KB Home has been pursuing a Returns-Focused Growth Plan that is designed to drive revenues and homebuilding operating income margin, return on invested capital, return on equity and leverage ratio. The plan's main components are executing the company's core business strategy, improving asset efficiency and monetizing significant deferred tax assets.

With the Returns-Focused Growth Plan in place, revenues and operating margin are expected to significantly improve in the near future.

In fiscal 2018, the company's return on equity increased 440 basis points (bps) to 14.4%. Notably, it expects 10-15% return on equity in fiscal 2019. In first-quarter fiscal 2019, its housing gross margin grew 100 bps, followed by 10 bps and 50 bps improvement in the fiscal second and third quarters, respectively. The upside reflected lower amortization of previously capitalized interest and a change in its accounting for certain model complex costs.

Notably, during the fiscal first, second and third quarters, the company achieved 10%, 17% and 18% improvement in average community count, respectively, with growth in each of the four regions served. KB Home also expects average community count to increase 10% and 12% year over year, respectively, in the fiscal fourth quarter and 2019.

The company is also focused on its core KB2020 business strategy which aims to boost scale in existing geographic footprint, improve profitability per unit, generate higher operating margin, drive earnings while generating positive cash flow to redeploy for growth and debt reduction.

- ▲ **Built-to-Order Approach Gives Competitive Advantage:** The company's Built-to-Order process provides buyers a wide range of choices in the major aspects of their future home along with a personalized customer experience through in-house community teams. This highly consumer-centric approach helps homebuyers to design a home with the features and amenities of their choice. Not only has this approach given KB Home competitive advantage over its peers, it has led to low-cost production.

The company follows a strategy of initiating construction only after a purchase agreement has been executed. This reduces inventory risk, enhances efficiencies in construction and provides greater visibility as well as predictability on future deliveries.

The company's built-to-order model provides higher revenues from premiums (lots, plans, and elevations), and design studio and structural options.

- ▲ **Aggressive Land Acquisition Strategy:** The company invests aggressively in land acquisition and development, mainly in high-end locations, which is critical for community count as well as top-line growth. This has eventually helped the company in reducing debt. It remains optimistic that this blend of rising active inventory, while reducing its annual interest incurred, is expected to boost future gross margin and returns.

After investing \$188 million and \$132 million in the fiscal first and second quarters, respectively, the company invested \$174 million in new land acquisitions in the fiscal third quarter. In fiscal 2018, the company invested \$1.9 billion in land and development compared with \$1.52 billion in fiscal 2017, \$1.4 billion in fiscal 2016 and \$967.2 million in fiscal 2015. KB Home expects the land investments to drive additional community openings throughout 2020 and produce year-over-year growth in average community count in the mid-single digit range in fiscal 2020.

- ▲ **Rebounding Housing Market Fundamentals Bode Well:** The U.S. housing market started building up strength since the beginning of 2019, after a torrid second-half 2018. Declining mortgage rates and moderate home prices have been adding strength to KB Home and other homebuilders. The overall homebuilding industry remains positive owing to ongoing traffic trends that indicate higher inclination of buyers, thereby reflecting a slow but steady housing recovery. Notably, declining interest/mortgage rates, lower construction costs, low unemployment and increasing wages are somewhat offsetting the other ongoing headwinds. Moreover, as more and more millennials are leaving their parents' home, a sharp spike in household formation is likely to translate into higher demand for new homes.
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## Reasons To Sell:

▼ **Lower Average Selling Price a Major Concern:** Although the U.S. market is gradually improving, ongoing housing market headwinds, especially affordability concerns, are still putting up hurdles for KB Home and other homebuilders. Due to the ongoing housing market uncertainty and affordability concerns, lower selling price is a major concern for KB Home. During the fiscal first, second and third quarters, ASP fell 5%, 8% and 7% from a year ago, respectively, mainly due to a shift in the geographic mix of homes delivered.

Lower ASP, higher construction and labor costs, along with competitive pricing pressure are pressing concerns.

▼ **Rising Labor and Land Costs:** Rising labor costs are threatening margins as they limit homebuilders' pricing power. Labor shortages are leading to higher wages and delays in construction, which eventually hurts the number of homes delivered.

Also, land prices are increasing due to limited availability. More inflation is anticipated, going ahead. This is denting homebuilders' margins considering that home prices are moderately increasing. In the fiscal third quarter, adjusted housing gross profit margin (excluding amortization of previously capitalized interest and inventory-related charges) contracted 80 bps year over year to 22.3%.

Meanwhile, U.S.-China trade tensions raise a concern. Notably, on May 9, 2019, the Trump administration raised tariffs from 10% to 25% on \$200 billion in China-made products. This prolonged trade war with China is gradually heating up, thereby creating challenges for the industry players.

▼ **Supply Constraints:** Several years of production deficits during the housing downturn limited the supply of both rental and new homes in the country. At present, a shortage of buildable lots, skilled labor and available capital for smaller builders are limiting home production, thereby lowering the inventory of homes, both new and existing. The labor market has also tightened with limited availability of labor arresting the rapid growth in housing production.

▼ **Federal Government Actions:** The housing industry is cyclical and affected by consumer confidence levels, prevailing economic conditions and interest rates. The federal government's actions related to economic stimulus, taxation and borrowing limits could affect consumer confidence and spending levels, which in turn could hurt both the economy and housing market.

Although strong economy and labor market strength provide the basis for strong demand, rising interest and mortgage rates may influence the rate-sensitive homebuilding industry. High mortgage rates dilute the demand for new homes as mortgage loans become expensive. This lower purchasing power of the buyers hurts volumes, revenues and profits of homebuilders.

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## Last Earnings Report

### KB Home's Q3 Earnings Beat, Revenues Miss Estimates

KB Home reported third-quarter fiscal 2019 results, wherein earnings beat analysts' expectation but revenues missed the same.

The results mainly benefited from continued progress of the Returns-Focused Growth plan, given stellar average community count growth. Although the company's top and bottom lines declined on a year-over-year basis, it remains upbeat about improvement in fiscal fourth-quarter results.

KB Home's \$2.3-billion backlog is expected to drive growth in 2020. It believes that declining mortgage/interest rates, steady economic growth and favorable demographics — in particular household formation — will continue providing a healthy backdrop for the housing industry, which includes biggies like Lennar, PulteGroup, Inc. and D.R. Horton, Inc.

### Earnings & Revenue Discussion

Quarterly earnings of 73 cents per share outpaced the Zacks Consensus Estimate of 65 cents by 12.3% but declined 16.1% from 87 cents a year ago.

Total revenues of \$1,160.8 million missed the consensus mark of \$1,170 million by 0.8%. In addition, the top line declined 5.3% year over year, mainly due to lower average selling price ("ASP") of homes delivered.

### Segment Details

**Homebuilding Revenues:** In the reported quarter, the segment's revenues fell 5.3% from the prior-year period to \$1,156.9 million due to lower ASP of homes delivered. While land generated \$4.2 million in revenues (up from \$2.3 million a year ago), housing revenues totaled \$1,152.6 million (declining from \$1,219.6 million). The decrease in housing revenues mainly stemmed from a decline in ASP in the West Coast region due to mix shift toward deliveries in lower-price inland markets and the absence of certain communities with relatively high ASPs that closed out in prior quarters.

Net orders grew 24% from the prior-year quarter to 3,325 homes, increasing in double digits across all regions served by the company. Value of net orders also increased 25% from the year-ago quarter to \$1.28 billion.

Moreover, number of homes delivered increased 1.1% from the year-ago level to 3,022 units. Deliveries increased in three regions (West Coast, Central and Southeast). However, ASP fell 7% from a year ago to \$381,400, mainly due to a shift in geographic mix of homes delivered. Lower ASP in the West Coast region also added to the woes.

At the end of the reported quarter, average community count was 255, up 18% year over year. Notably, net orders per community averaged 4.3 per month in the quarter, up from 4.1 recorded in the prior year. The company's backlog totaled 6,230 homes (as of Aug 31, 2019), up 14% from a year ago. Potential housing revenues from backlog grew 13% from the prior-year period to \$2.04 billion.

### Margins

Housing gross margin increased 50 bps year over year to 18.5% in the quarter. The increase reflects lower amortization of previously capitalized interest and a change in its accounting for certain model complex costs.

Adjusted housing gross profit margin (a metric that excludes the amortization of previously capitalized interest and inventory-related charges) declined 80 bps year over year to 22.3%.

As a percentage of housing revenues, selling, general and administrative (SG&A) expenses were 11.1%, up 170 bps from the year-ago figure. The rise was mainly led by lower housing revenues, higher marketing expenses to support new community openings and the impact of ASC 606 adoption.

Homebuilding operating margin deteriorated 120 bps on a year-over-year basis to 7.4%. After adjusting for inventory-related charges, operating margin came in at 7.8%, down 150 bps.

**Financial Services** revenues grew 13.2% year over year to \$3.9 million.

### Financial Position

KB Home had homebuilding cash and cash equivalents of \$183.8 million as of Aug 31, 2019, lower than \$574.4 million on Nov 30, 2018. Inventories were \$3,919.1 million, up from \$3,582.8 million as of Nov 30, 2018. KB Home had total liquidity of \$610.8 million at the end of the quarter.

The company spent nearly \$442 million, of which 39.4% was allotted for new land acquisitions in the quarter.

Its debt-to-capital ratio was 45.1% (which improved 460 bps from Nov 30, 2018). Net debt to capital ratio was 42.6% in the quarter.

### Fiscal Q4 Guidance

KB Home expects average community count to increase 10% year over year in the fourth quarter and 12% in 2019.

It expects fourth-quarter housing revenues in the range of \$1.56-\$1.64 billion (indicating growth from \$1.34 billion in the prior year) and ASP to be

Quarter Ending **08/2019**

Report Date	Sep 25, 2019
Sales Surprise	-0.79%
EPS Surprise	12.31%
Quarterly EPS	0.73
Annual EPS (TTM)	2.51

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around \$400,000-\$410,000 (implying improvement from \$395,200 a year ago).

Assuming no inventory-related charges, the company expects housing gross margin to improve sequentially and on a year-over-year basis to the range of 18.8-19.5%.

Homebuilding operating margin — excluding the impact of any inventory-related charges — is expected within 9.9-10.5% (suggesting an increase from 9.7% a year ago).

Moreover, SG&A ratio is projected in the range of 8.8-9.2%.

Effective tax rate is estimated to be 28% for the quarter.

**Preliminary 2020 Targets**

KBH expects revenues in the range of \$4.9-\$5.3 billion. The company believes that it should benefit from the land investments over the past 12 months, thereby helping it to achieve community growth in mid-single digits on a year-over-year basis.

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## Valuation

KB Home shares are up 65% in trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are up 30.7% and 29.2% in the past year.

The S&P 500 index is up 24.2% in the past year.

The stock is currently trading at 10.35X forward 12-month price to earnings, which compares to 10.41X for the Zacks sub-industry, 15.69X for the Zacks sector and 18.74X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.8X and as low as 5.53X, with a 5-year median of 10.06X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$38 price target reflects 10.86X forward 12-month earnings.

The table below shows summary valuation data for KBH

Valuation Multiples - KBH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	10.35	10.41	15.69	18.74
	5-Year High	16.8	15.08	18.83	19.34
	5-Year Low	5.53	7.3	10.63	15.17
	5-Year Median	10.06	10.74	15.97	17.44
P/B TTM	Current	1.42	1.38	3.8	4.42
	5-Year High	1.73	2.27	7.22	4.45
	5-Year Low	0.52	1.01	2.19	2.85
	5-Year Median	0.95	1.57	3.4	3.6
P/S F 12M	Current	0.61	0.97	1.89	3.47
	5-Year High	0.7	1.23	2.23	3.47
	5-Year Low	0.25	0.65	1.25	2.54
	5-Year Median	0.42	0.92	1.63	3

As of 01/07/2020

## Industry Analysis Zacks Industry Rank: Top 43% (109 out of 254)



## Top Peers

Century Communities, Inc. (CCS)	Neutral
M.D.C. Holdings, Inc. (MDC)	Neutral
M/I Homes, Inc. (MHO)	Neutral
Meritage Homes Corporation (MTH)	Neutral
Taylor Morrison Home Corporation (TMHC)	Neutral
Beazer Homes USA, Inc. (BZH)	Underperform
TRI Pointe Group, Inc. (TPH)	Underperform
Lyon William Homes (WLH)	Underperform

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	KBH Neutral	X Industry	S&P 500	MHO Neutral	MTH Neutral	TMHC Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>B</b>	<b>A</b>	<b>C</b>
Market Cap	3.21 B	2.41 B	23.82 B	1.14 B	2.41 B	2.42 B
# of Analysts	7	3	13	1	10	3
Dividend Yield	0.99%	0.00%	1.8%	0.00%	0.00%	0.00%
<b>Value Score</b>	<b>B</b>	-	-	<b>B</b>	<b>B</b>	<b>B</b>
Cash/Price	0.06	0.10	0.04	0.03	0.19	0.10
EV/EBITDA	12.83	9.69	13.92	11.23	10.51	14.42
PEG Ratio	1.29	1.03	2.00	NA	1.03	NA
Price/Book (P/B)	1.42	1.20	3.32	1.20	1.29	0.97
Price/Cash Flow (P/CF)	10.99	8.93	13.58	8.80	9.91	7.88
P/E (F1)	10.63	10.16	18.86	8.08	9.33	7.16
Price/Sales (P/S)	0.74	0.71	2.63	0.46	0.69	0.51
Earnings Yield	9.60%	9.85%	5.30%	12.38%	10.72%	13.97%
Debt/Equity	0.82	0.62	0.72	0.91	0.70	0.87
Cash Flow (\$/share)	3.30	3.60	6.94	4.72	6.36	2.91
<b>Growth Score</b>	<b>D</b>	-	-	<b>C</b>	<b>A</b>	<b>D</b>
Hist. EPS Growth (3-5 yrs)	37.58%	16.48%	10.56%	28.99%	14.41%	10.59%
Proj. EPS Growth (F1/F0)	22.45%	11.41%	7.49%	5.33%	19.22%	13.48%
Curr. Cash Flow Growth	53.52%	18.07%	14.83%	27.81%	41.54%	151.49%
Hist. Cash Flow Growth (3-5 yrs)	44.96%	23.21%	9.00%	22.91%	13.19%	45.69%
Current Ratio	4.82	4.78	1.23	5.93	1.30	7.32
Debt/Capital	45.12%	36.98%	42.92%	47.64%	41.15%	46.48%
Net Margin	5.58%	6.29%	11.08%	4.77%	6.29%	4.40%
Return on Equity	11.18%	12.10%	17.16%	13.78%	12.42%	12.50%
Sales/Assets	0.86	0.97	0.55	1.19	1.02	0.91
Proj. Sales Growth (F1/F0)	13.92%	4.60%	4.15%	3.94%	7.88%	4.60%
<b>Momentum Score</b>	<b>A</b>	-	-	<b>C</b>	<b>B</b>	<b>A</b>
Daily Price Chg	1.71%	0.00%	-0.22%	2.22%	1.71%	0.35%
1 Week Price Chg	2.89%	0.50%	-0.30%	0.58%	0.67%	0.50%
4 Week Price Chg	3.66%	-1.04%	2.11%	-9.22%	-4.87%	-1.04%
12 Week Price Chg	4.35%	2.23%	5.70%	9.55%	-13.29%	-13.38%
52 Week Price Chg	71.69%	33.22%	22.84%	66.19%	53.03%	25.26%
20 Day Average Volume	1,236,810	255,777	1,570,747	255,777	498,206	1,345,569
(F1) EPS Est 1 week change	0.45%	0.00%	0.00%	0.00%	0.15%	0.00%
(F1) EPS Est 4 week change	0.77%	0.00%	0.00%	0.00%	0.15%	1.99%
(F1) EPS Est 12 week change	1.05%	0.87%	-0.53%	11.98%	5.97%	4.15%
(Q1) EPS Est Mthly Chg	1.81%	0.00%	0.00%	0.00%	0.00%	0.00%



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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>B</b>
Growth Score	<b>D</b>
Momentum Score	<b>A</b>
VGM Score	<b>C</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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